

Surrey Pension Fund

Annual Report 2007





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Introduction

This annual report sets out key information about how the Fund is managed for the benefit of all employing bodies, contributors and beneficiaries.

Review of fund performance

During 2006-2007 the Surrey Fund returned 7%, exactly in line with both the customised benchmark return and average local authority return. Returns in 2006-2007 were good compared with assumptions but clearly not as good as 2005-2006 when the Fund returned 24.9%. Performance figures for the Fund's managers are shown on page 19 and Paul Meredith, the Fund's independent adviser, explains the market background in some depth on page 13.

The Investment Advisors Group (IAG) takes a long-term view of investment performance. We will not have rolling 3-year performance figures compared to the current customised benchmark until February 2008. We do still subscribe to the local authority peer group and over a rolling 3-year period to the end of March 2007 the Fund returned 14.4% p.a. compared to the local authority average of 14.3% p.a.. This placed the Fund in the 5th decile in the local authority league table – which is outside our target of top quartile but all local authorities have differing asset allocation strategies, which are dependant on fund liability structures. We are therefore not comparing like with like when assessing performance against the peer group, although it is a useful reference point for us.

Fund management structure

Some managers disappointed over 2006-2007 and struggled to outperform against benchmark. The IAG reviews manager performance on a regular basis and assesses the potential for reaching targets over the

longer-term. Decisions to terminate manager mandates are not taken lightly – the old adage that past performance is not always a guide to future performance is worth remembering. It is crucially important to make an assessment of the costs of change – whether these be explicit costs in relation to portfolio turnover, or the time and expertise involved in implementing decisions. There is also the potential cost associated with terminating managers simply because the market environment is not favourable to a manager's investment approach over the short-term. Such regret risk is a major factor to consider.

During 2006-2007 one of the UK equity mandates (Soc Gen) was terminated. This was a consequence of a review of the Fund's asset allocation structure, which has resulted in a reduction in the Fund's allocation to UK equity, coupled with concerns about the manager's long-term ability to meet performance expectations. Assets previously held by Soc Gen were transferred to the Fund's passive manager (Legal & General) to be managed on a temporary basis pending the appointment of a new global equity manager.

The decision to increase the Fund's weighting to global equity was drawn from the results of an asset-liability modelling study, which took place late in 2006. The study confirmed that the Fund's allocation to equities v bonds/property should be maintained. Further work was undertaken to assess whether the allocation to equities should be revised – and it was concluded that the weighting to global equity should be increased at the expense of UK equity. It was also agreed to increase the Fund's weighting to property and to investigate the potential for awarding a currency mandate. These matters should be resolved early in 2008.

The year ahead

Looking forward, we have a number of major challenges. We continue to have a large number of managers to work with and monitor. We will also be implementing the changes in the Fund management structure that were instigated during 2006-2007. Finally, and of most concern to the employers in the Fund, we will be receiving the results of the 2007 actuarial valuation.

A handwritten signature in dark blue ink, appearing to read 'Philip Walker', written in a cursive style.

Philip Walker
Head of Finance
October 2007

Members and Advisers

Administering Authority

Surrey County Council
County Hall
Kingston upon Thames
Surrey
KT1 2EA

Administrator

Head of Finance

Investment Advisers

County Council Members

David Harmer
Peter Langham
Val Tinney
Chris Slyfield

Representatives of Employing Bodies

Cllr Nick Harrison, Reigate & Banstead BC
Cllr Paul Tuley, Runnymede BC

Employee Representative

Don Josey

Professional Investment Advisers

Bob Mundie, Watson Wyatt
Paul Meredith, Independent

Head of Finance

Philip Walker

Fund Managers

Citigroup Asset Management
ING Real Estate
JP Morgan Asset Management
Legal and General Investment Management
Majedie Asset Management
Marathon Asset Management
Mirabaud Investment Management Ltd
Schroder Investment Management Ltd
SG Asset Management (to 1 December 2006)
TCW Investment Management Company
UBS Global Asset Management
Western Asset Management

Global Custodian

Northern Trust

Private Equity Advisers

Goldman Sachs Asset Management
HG Capital
ISIS Equity Partners
Blackrock (formerly Merrill Lynch)
Standard Life

Fund Actuary

Bryan Chalmers, Hymans Robertson

AVC Provider

Prudential Assurance Company
Equitable Life Assurance Society

Auditors

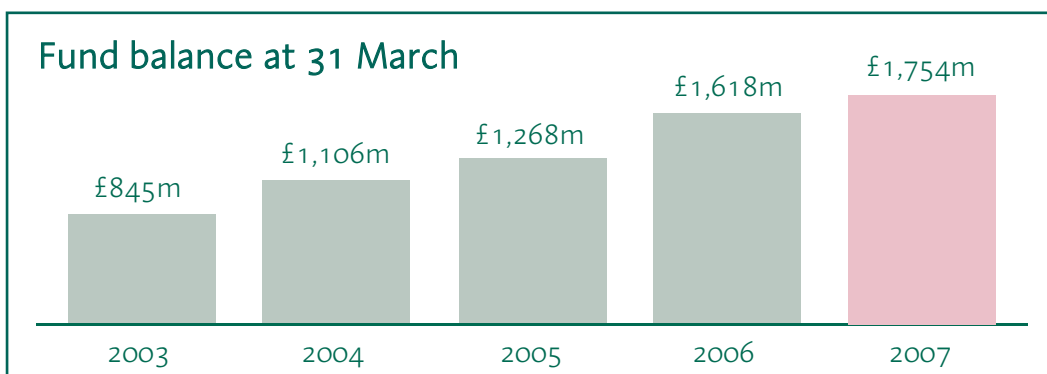
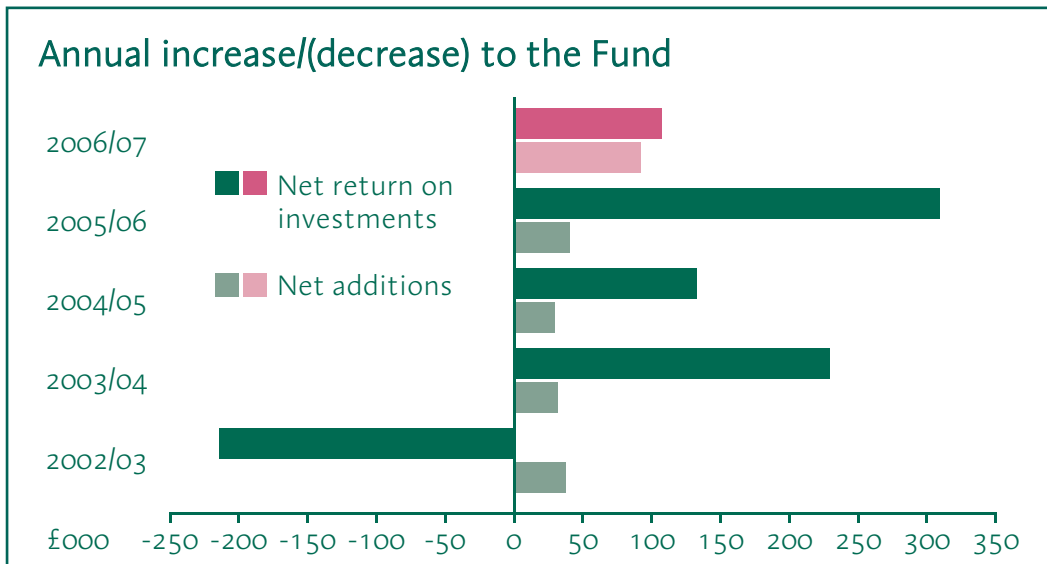
Audit Commission

Five Year Profile

Financial Summary

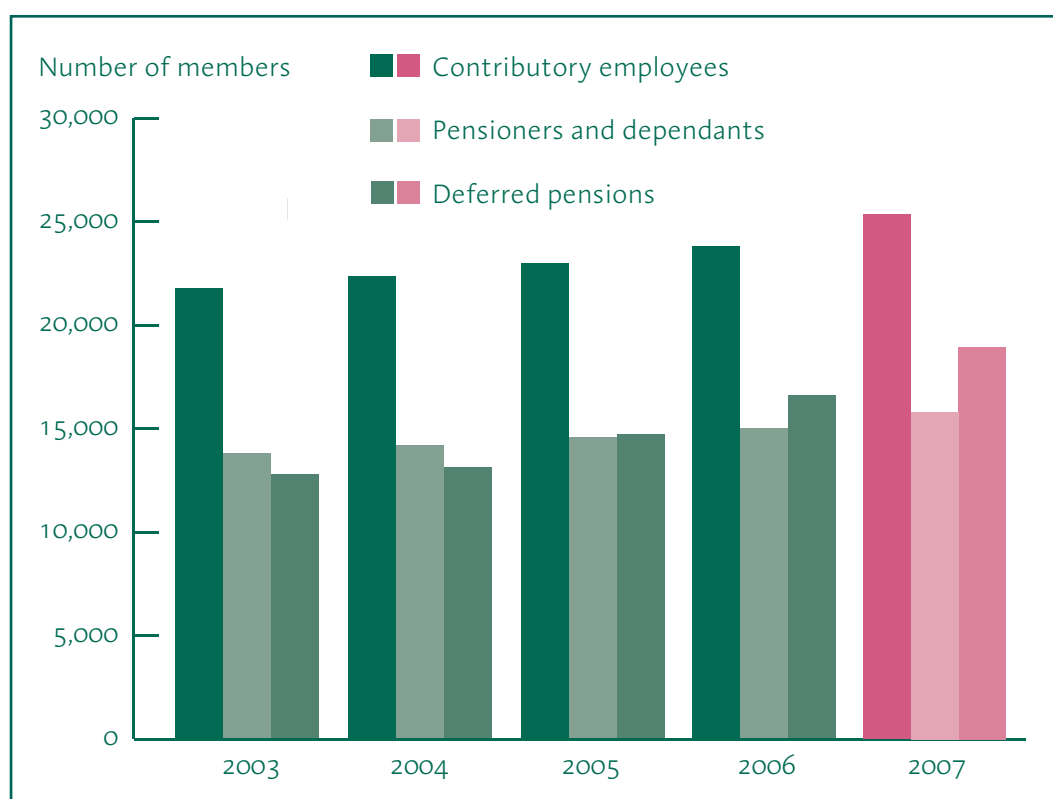
	2002/03 £000	2003/04 £000	2004/05 £000	2005/06 £000	2006/07 £000
Contributions	105,242	102,357	107,106	122,046	120,932
Less benefits and expenses paid	67,770	70,701	77,272	81,393	92,422
Net additions	37,472	31,656	29,834	40,653	28,510
Net investment income **	25,576	39,682	24,516	27,900	30,600
Change in Market Value	(240,153)	189,320	107,797	281,492	76,770
Net return on investments	(214,577)	229,002	132,313	309,392	107,370
Net increase in fund	(177,105)	260,658	162,147	350,045	135,882
Fund balance at 31 March (Market value)	844,897	1,105,555	1,267,702	1,617,747	1,753,629

**Net of expenses



Membership Summary

	2002/03	2003/04	2004/05	2005/06	2006/07
Contributory employees					
Scheduled bodies	20,187	20,743	21,184	22,122	23,781
Admitted bodies	1,593	1,612	1,796	1,719	1,574
	21,780	22,355	22,980	23,841	25,355
Pensioners and dependants					
Scheduled bodies	13,112	13,426	13,736	14,109	14,816
Admitted bodies	712	770	839	906	997
	13,824	14,196	14,575	15,015	15,813
Deferred pensions					
Scheduled bodies	11,879	12,209	13,674	15,431	17,606
Admitted bodies	907	945	1,037	1,189	1,321
	12,786	13,154	14,711	16,620	18,927
Total membership	48,390	49,705	52,266	55,476	60,095



Pensions Report

Regulatory Background

Pensions regulations

The Local Government Pension Scheme Regulations 1997 are made under the 1972 Superannuation Act and require the County Council to maintain a pension fund for certain of its own employees together with the majority of employees of Probation Committees, the District Councils within the County area and eligible employees within the Surrey Police Authority and former County Educational Establishments. The same regulations empower the County Council to admit certain other bodies to the Fund and a list of such bodies within the Fund is shown on page 33. The regulations also allow for the admission of private sector contractors providing outsourced services. The Fund does not cover teachers and fire fighters for whom separate statutory regulations exist.

The Fund is financed by contributions from employees and employers, together with income earned from investments. The surplus of contributions and investment income over benefits currently being paid is invested. The core benefits payable under the 1997 Regulations are mandatory. In addition the regulations have become more flexible to give members and employers the maximum freedom of choice in determining their benefits package. Employees' contributions are now standardised at the rate of 6% of pensionable pay although there is a protected rate of 5% for certain existing employees who were previously classed as manual workers.

Employers' contribution rates are set following each Actuarial Valuation. A valuation of the Fund's financial position must be made every three years when the Actuary certifies the

employers' rates payable until the results of the next valuation are known.

Under the regulations employer contributions are determined in two parts.

- a common rate based on the existing and prospective liabilities of the Fund having regard to the circumstances common to all the participating employers and to the desirability of maintaining as nearly constant a rate as possible and
- individual adjustments arising from circumstances peculiar to an individual employer.

Pensions paid to retired employees, and benefits with a deferred payment date, are subject to mandatory increases under pensions increase legislation. The cost of inflation-proofing benefits is funded through the employers' contribution rate.

Employers' contributions in 2006/2007

The results of the actuarial valuation undertaken at 31 March 2004 applied for the three years commencing 1 April 2005 as detailed below:

- The common contribution rate payable by each participating body in order to maintain funding for future service at 100% of liabilities is 193% of pensionable employees' contributions **and**
- an individual adjustment to the common rate which is expressed as a percentage of pensionable employees' contributions together with a cash amount for most Scheduled Bodies.

The basis and assumptions used are found in the Actuary's disclosure statement on page 20.

The contributions payable by scheme employers in 2006/2007 are shown on pages 31 – 33.

Future contribution rates

The contribution rates applying in the three-year period commencing 1 April 2005 were determined by the Actuary on completion of his triennial review of the Fund as at 31 March 2004. He assessed the Fund's current and future liabilities and determined that it was necessary to increase the rate of employers' common contribution from 160% to 193% of pensionable employees' contributions. He also determined the additional annual sums to be paid by most employers to ensure a return to 100% solvency over the average future working lifetime of the members (20 years).

The contribution rates applying for the three-year period commencing 1 April 2008 will be determined by the Actuary on completion of his triennial review of the Fund as at 31 March 2007.

Annual Review

Amendments to the Local Government Pension Scheme Regulations 1997

The Department of Communities and Local Government (CLG) have published amendment regulations to introduce a new Local Government Pension Scheme from 1 April 2008.

The CLG had promised that the regulations to introduce the new scheme would be published in time to allow a 12-month lead in to the actual implementation of the new scheme on 1 April 2008. Unfortunately, the CLG have not met this deadline and, at the time of writing this report, two of the three major pieces of amending regulations are still in draft form and the final

regulations that have been published contain several errors that require amending. Therefore, the following summary of the main provisions of the new scheme may be subject to some change before April 2008.

Membership

Employees will only be able to join the scheme if they have a contract of employment of three or more months' duration.

Contributions

Currently the majority of employees pay 6% of their pay in pension contributions, with some ex-manual workers paying a lower rate of 5%. Under the new scheme employees will pay pension contributions at a rate determined by their full time equivalent level of pay as follows:

FTE Pay		Contribution rate
£0	- £12,000	5.5%
£12,000.01	- £14,000	5.8%
£14,000.01	- £18,000	5.9%
£18,000.01	- £30,000	6.5%
£30,000.01	- £40,000	6.8%
£40,000.01	- £75,000	7.2%
£75,000.01	or more	7.5%

The increase in contribution rate for the ex-manual worker employees paying 5% will be phased in, so that by April 2011, they will be paying the appropriate rate under the above table.

Currently the average employee contribution rate for the scheme as a whole is 5.8%. It is envisaged that under the new scheme the average employee rate for the scheme as a whole will increase to 6.3%.

Benefit structure

The pension accrual rate in respect of pensionable service from 1 April 2008 will increase from $\frac{1}{80}$ th to $\frac{1}{60}$ th, but there will be no automatic lump sum. A lump sum can be provided for by commuting or giving up part of the pension at the rate of £12 of lump sum for every pound of pension commuted. Pension benefits accrued to 31 March 2008 will remain unchanged and will be calculated at the rate of $\frac{1}{80}$ th pension and $\frac{3}{80}$ th lump sum.

The normal retirement age will remain the same under the new scheme at age 65. In cases of normal voluntary retirement before age 65, pension benefits accrued from 1 April 2008 will be subject to an actuarial reduction if taken between age 60 and 65. However, if under the current scheme the scheme member would have had the right to receive an unreduced pension between age 60 and 65 under the 85-year rule, they will continue to be able to do so in respect of pension benefits that accrue in respect of service to 31 March 2008. (The 85-year rule is where the member's age plus pensionable service in whole years equals or exceeds 85).

Additional protection applies to scheme members who reach age 60 and satisfy the 85-year rule before 1 April 2016. In these cases a reduction would not be applied to benefits accrued in respect of service from 1 April 2008 to 31 March 2016. Consultation is currently taking place on extending this date from 31 March 2016 to 31 March 2020.

- **Dependant's pensions**

Cohabiting partners will be eligible for payment of a survivors pension in the same way as is provided under the current scheme for spouses and civil partners.

- **Ill health retirement**

A two-tier ill health retirement provision will replace the single tier provision of the current scheme. The current scheme provides the same scale of benefits to all who are retired on permanent ill health grounds, irrespective of the level of their incapacity or potential re-employment capability. The intention of the two-tier system is to provide a greater level of benefits to those who are most in need.

- **Death benefits**

The lump sum death in service payment will be increased from 2 years pensionable pay to 3 years.

The minimum pension payment guarantee will be increased from 5 years pension to 10 years.

- **Purchasing additional pension**

Scheme members will not be able to purchase additional periods of service (added years contracts) under the new scheme. Instead of buying added years there will be a facility to purchase specific amounts of pension from £250 to £5,000 per year. Members with existing added years contracts will be permitted to continue with their contracts.

New scheme employers

East Surrey Rural Partnership joined the scheme on 3 July 2006.

Investment Report

Investment Management

Investment powers

The principal powers governing investment activity and management are defined in the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 (as amended) which permit a wide range of investments subject to the following restrictions:

- No more than 15% of the Fund may be invested in securities that are not quoted on a recognised stock exchange.
- No more than 10% of the Fund may be invested in a single holding, and no more than 35% of the Fund may be invested in unit trust schemes managed by any one body and open-ended investment companies managed by any one body.
- No more than 10% of the Fund may be deposited with any one bank.
- Loans from the Fund, including money used by the administering authority or lent to other local authorities, but not including loans to the government, may not in total exceed 10% of the value of the Fund.

Investment management

The main regulatory stipulations applying during the year were:

- an administering authority may appoint one or more investment managers to manage and invest fund monies on its behalf.
- when appointing fund managers the administering authority:
 - must be aware that the investment manager is suitably qualified
 - must be satisfied that there are an adequate number of managers and that the sums to be managed by any one will not be excessive

- must take proper advice
- the investment manager must provide at least once every three months a report setting out his actions.
- the investment manager must have regard to the need for diversification of investments of fund monies and to the suitability of investments which he proposes to make.
- the regulations also impose requirements concerning the terms of appointment and the reviews of the performance of fund managers.

In November 2003 an amendment to the Local Government Pension Scheme Regulations was introduced. This amendment provides local authorities with the opportunity to increase their exposure to certain types of investment, but only where:

- proper advice has been obtained
- the decision has been made with due regard to the general provisions of the regulations
- the Statement of Investment Principles has been revised and published.

The headrooms are not mandatory and individual authorities can, if they prefer, maintain existing investment policy. Surrey has decided to maintain its existing investment policy at this moment in time.

However, a temporary increase in the amount that could be invested in unit trust schemes managed by any one body – from 25% to the 35% permitted by Regulations – was applied to enable Legal and General to passively manage assets that were transferred from SG Asset Management on the termination of that UK Equity mandate.

At Surrey the responsibility for the overall direction of the Fund's investment is delegated to the Head of Finance who acts in consultation with the Chairman of the Investment Advisers Group. The Investment Advisers Group comprises:

- 4 County Council members
- 2 District Council members
- 1 representative of the scheme members
- 2 professional investment advisers

the Fund is separated into three elements

- passive core
- specialist core
- satellite

There are a number of external investment managers, who have been appointed to undertake day-to-day decisions on the allocation

of investment between types of asset and choices of individual stocks within approved classes. They are required to take a long-term view, balancing risk against return and are remunerated on scales related to the value of funds under management. Twice yearly meetings are held with the external managers who explain the reasons for their actions, and propose a strategy for the coming period.

In addition the Fund has investments in private equity funds managed by ISIS Equity Partners, H G Capital, Blackrock, Goldman Sachs and Standard Life with some residue funds in Bridgepoint Capital (formerly funds managed by Gartmore Asset Management). At 31 March 2007 the market value of assets under management (excluding assets held by Surrey County Council) was £1,721 million; the proportion with each of the managers being:

Investment Manager	Mandate	Funds under management £m	Proportion of funds under managements
Passive Core Legal & General Investment Managers	Multi asset	562.8	32.7%
Specialist Core UBS Global Asset Management Marathon Asset Management Western Asset Management ING Real Estate	UK/global equities Global equities Fixed interest Property	277.0 170.6 225.6 110.8	16.0% 9.9% 13.1% 6.4%
Satellite Mirabaud Majedie TCW JP Morgan Citigroup Schroders	UK equities UK equities US equities Japanese and Pacific Basin equities Emerging markets equities European equities	69.8 71.4 42.4 50.4 59.3 55.5	4.1% 4.2% 2.5% 2.9% 3.5% 3.2%
Other	Private equity	25.6	1.5%

Market Background

(Courtesy of Paul Meredith, independent investment adviser)

Economic and market background

The global economy enjoyed a further year of good growth thanks to the continuing benign combination of rapid industrialisation in the East and modest inflation and low interest rates in the West. China and Southern Asia have supplied developed consumer markets with goods at prices that simply can't be matched at developed world labour costs and India has increasingly provided services to the English speaking business world. This globalisation has been a powerful restraint on the price of durable goods, services and labour, and permitted lower interest rates in the West than would otherwise have been the case, albeit US interest rates have gradually risen from extreme low levels. For many industrial companies worldwide conditions have been very favourable.

The financial sector profited from the success of its customers with banks experiencing a prolonged period of low bad debts, particularly in their core corporate market. Credit became notably cheap and plentiful with extra liquidity provided by rapid growth in securitised assets, with incentives to the originators that may well have helped to exaggerate this credit cycle. Easy credit was also a stimulus to the consumer and to house prices. It also facilitated increased corporate acquisition and leveraged buy-out activity. London has been at the heart of much of this and has gradually become established as the main financial centre of Europe and of several global sectors.

UK companies involved in wholesale financial services and international business experienced boom times. But for what remains of traditional mass manufacturing and agriculture and those

that service them, this bonanza and the associated strength of sterling must have seemed like the last straw. For the domestic economy, conditions have been between these extremes with consumer confidence reasonable, plentiful cheap labour from an extended European Community and some growth in public spending.

A high level of merger and acquisition activity and unprecedented levels of private equity involvement across Europe drove valuations of all but the very largest companies. Towards year end the rise in interest rates and signs of weakness in US housing and mortgages provided some restraint. The UK equity market returned 11%, well short of all the preceding three years of sharp recovery from the trough in early 2003 but still above the average over five years of 9%pa, as this includes the significant down year in 2002/3. Returns from European equities were marginally higher at 12% [10%pa over five years] and emerging markets returned 7% [17%]. The weakness of the dollar and yen restricted the returns in North America and Pacific Basin, respectively – 1% [0%] and – 2% [9%]. UK property produced another excellent return at 18% [15%] with London offices to the fore. Fixed interest and index-linked gilts were muted, returning respectively 1% [5 %] and 3% [7%].

Outlook

Even the main equity markets have doubled in value since early 2003, climbing the usual “wall of worry” including latterly the August 2007 “credit crunch”. The genesis of this latest crisis was the slowdown in US housing sales and distress in the associated “sub-prime” mortgage market. This highlighted the difficulty in pricing many “asset backed securities” which incorporate these dubious mortgages.

With banks' liabilities uncertain, they naturally hoarded cash and the resulting atrophy of the inter-bank money market led to a run on Northern Rock in the UK and interest rate cuts in US and Euro. Credit conditions will not quickly revert to earlier profligacy. However the authorities have been exposed as doing everything within their powers to avoid any significant impact on the wider economy despite the serious long-term moral hazard implications of bailing out the investment banking instigators and their stooges in regional and mortgage banks.

At the time of writing [3 October 2007] equity investors seem to have taken their cue by treating recently reported banking provisions as a "one-off". The engine of world growth is increasingly in Asia and valuations of major global businesses on most traditional measures are not high given the strong trend growth seen in earnings, dividends and share buy-backs. Nevertheless current profit margins are exceptionally high and reversion to the benign globalisation scenario of recycled surpluses, solid economic growth, modest inflation and low market volatility should not be taken for granted.

Oil is one potential risk. It will remain a key component of economic activity for several decades. Demand seems to have become less sensitive to price and likely to gradually outstrip supply, which is often constrained by nationalistic policies that do not always employ the latest extraction technology. Moreover the isolation of Iran, potential instability in the Arabian peninsular and the debacle in Iraq provide a threat even to existing supplies. Russia is flexing its growing oil and gas based muscle and China is determined to procure and

safeguard its own oil and mineral needs in Africa.

China's economy still shows no sign of any easing in its breakneck growth with output doubling approximately every six or seven years. The resulting rapid increase in living standards is a powerful stimulus for cooperation but the mass exodus from the countryside to city is causing enormous social strains. Central state control has managed to muddle through without resorting to excessive force partly because the Chinese leadership has shown remarkable collegiality and pragmatism, to date. With widespread official corruption, weak property rights, the majority of the population economically disenfranchised and unrest on its borders, it is unlikely that this momentous transition to a developed modern state will be entirely serene. With China now a major component in the global economy any disruption could have significant ramifications.

Markets are also vulnerable to exchange rate instability particularly in the world's main reserve currency, the dollar. The US trade deficit has stabilised but at a level that still requires growing Asian manufacturing and Middle Eastern oil surpluses to be recycled substantially in dollars. Personal oil wealth from the Middle East and Russia has also sought a home [and homes] in the UK and with a spate of takeovers of UK companies by foreign buyers sterling has been strong. This sale of domestic assets, whether of Treasury bonds, companies, property or infrastructure could in theory continue for many years but if it begins to feel like the "rake's progress" then investors may take fright and US and UK trade imbalances may again loom large.

Western democratic leaders struggle with the conflicting needs to attract the most competitive global professional service industries and to moderate the resulting growing inequality in domestic wealth. Pressure comes through the ballot box with job losses in traditional labour-intensive industries hitting the headlines and the regional if not national psyche, particularly in the US, whereas the steady accumulation of high tech and service jobs is mainly piecemeal and goes largely unreported. Calls for protection of “key” industries and their workers become hard to resist and inhibit progress on international co-ordination on free trade and related ecological issues.

Even if economic conditions stay reasonably robust, more normal credit conditions and even a partial return to traditional banking values may dampen financial innovation and reduce takeover activity. Equity returns can hardly continue to replicate the meteoric rises of the last four years. Alternatives are unlikely to do any better. Bond yields offer only fairly modest premia over expected inflation. UK commercial property prices, particularly London offices, have been reflecting a “squeeze” on supply, with the cost of finance well above rental income, but it seems likely that this bubble has burst.

Strategic asset allocation

Following a review by Hymans Robertson it was decided in February 2007 that the bulk of the Fund, 72%, continue to be held in equities to produce the higher long-term returns that should help to minimise employer contributions. This balance is struck with bonds and property providing diversification and hence moderating potential short-term upward fluctuations in those contributions if equity markets again suffer a major downturn as in 2000-3. The exposure to property is being increased marginally at the expense of equities. The property manager [ING] has recommended that the incremental investment should be directed to European commercial property funds and this has been approved.

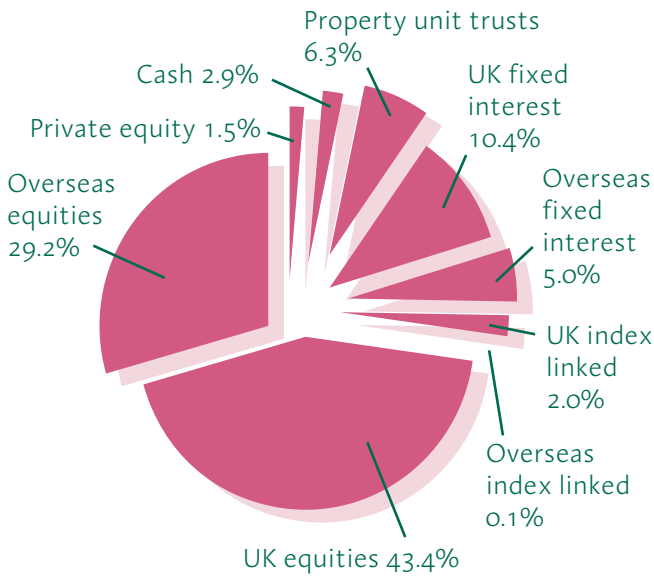
Historically the Fund’s equity exposure has been predominantly in the UK stockmarket [in recent years 62.5%]. However this has become increasingly concentrated on a few multinational corporations and therefore less representative of the UK economy, so the proportion will be adjusted to 50% in the current year with the appointment of a new overseas equity manager. At the same time the overseas equity benchmark distribution will move some way from the former equal weights for North America, Europe [ex UK] and Pacific Basin towards market capitalisation, which weights the US more highly. There has historically been some risk benefit from hedging part of the associated overseas currency exposure back into sterling and it has been decided that 50% of the underlying exposure to major currencies will be hedged.

Portfolio distribution

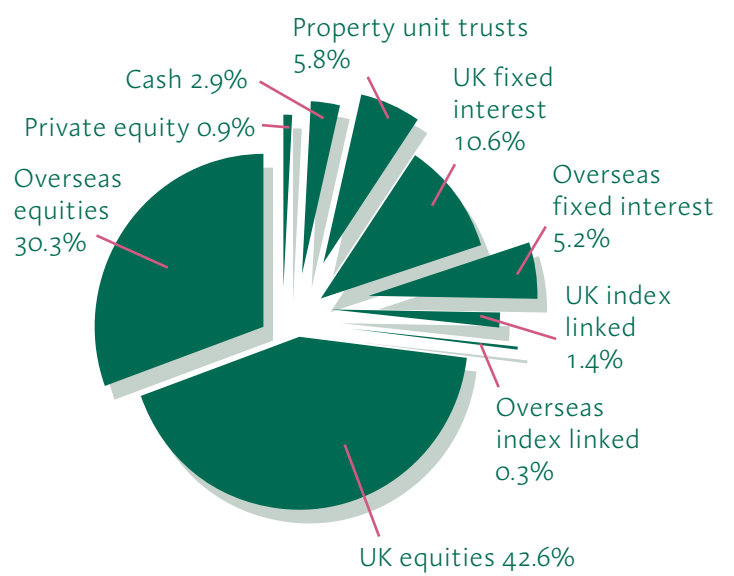
The distribution of the portfolio at 31 March 2007 and 2006 is shown below. The top charts show distribution over the entire structure of the portfolio, whereas the bottom charts provide more detailed analysis of the overseas equity sectors.

Portfolio distribution at 31 March

31 March 2007

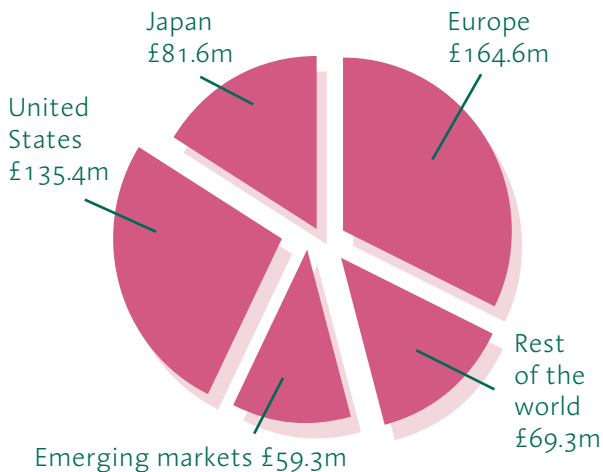


31 March 2006

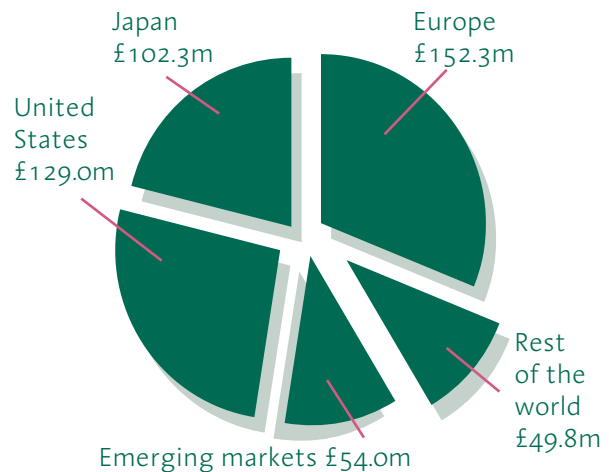


Overseas equities distribution at 31 March

31 March 2007

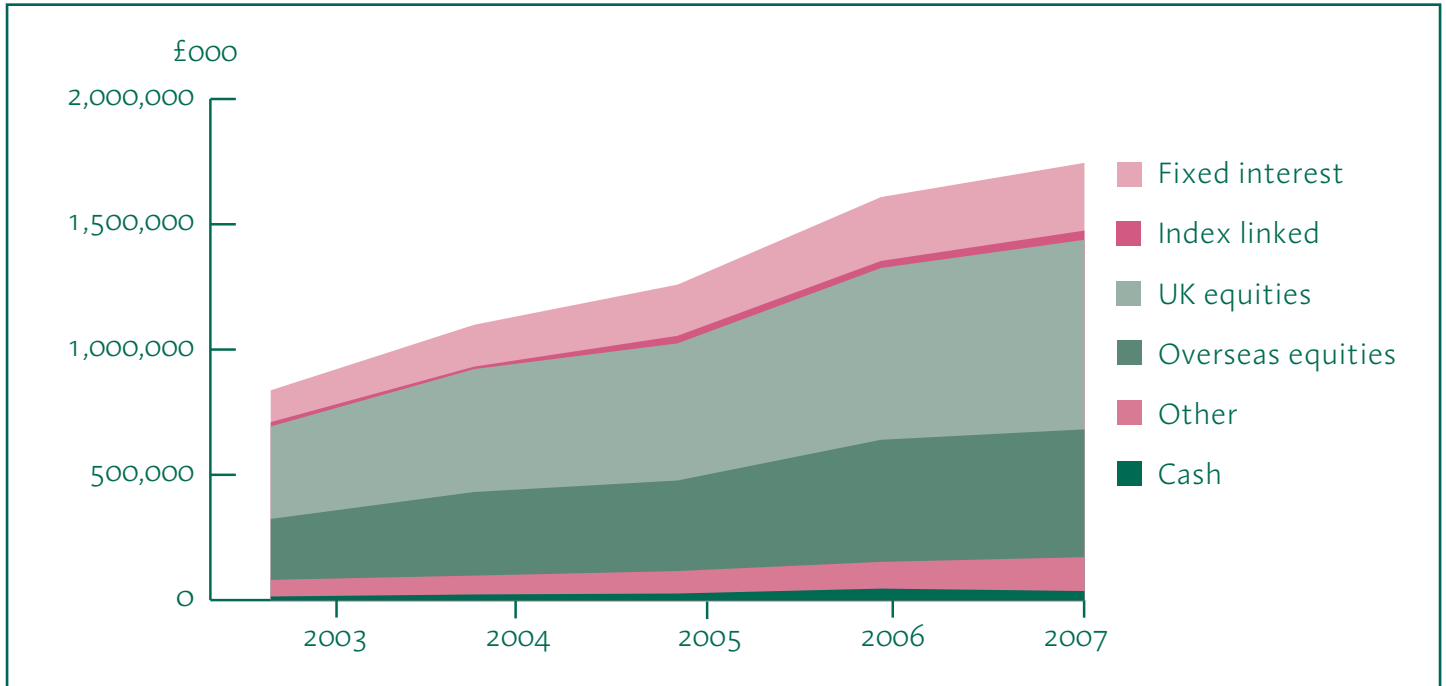


31 March 2006



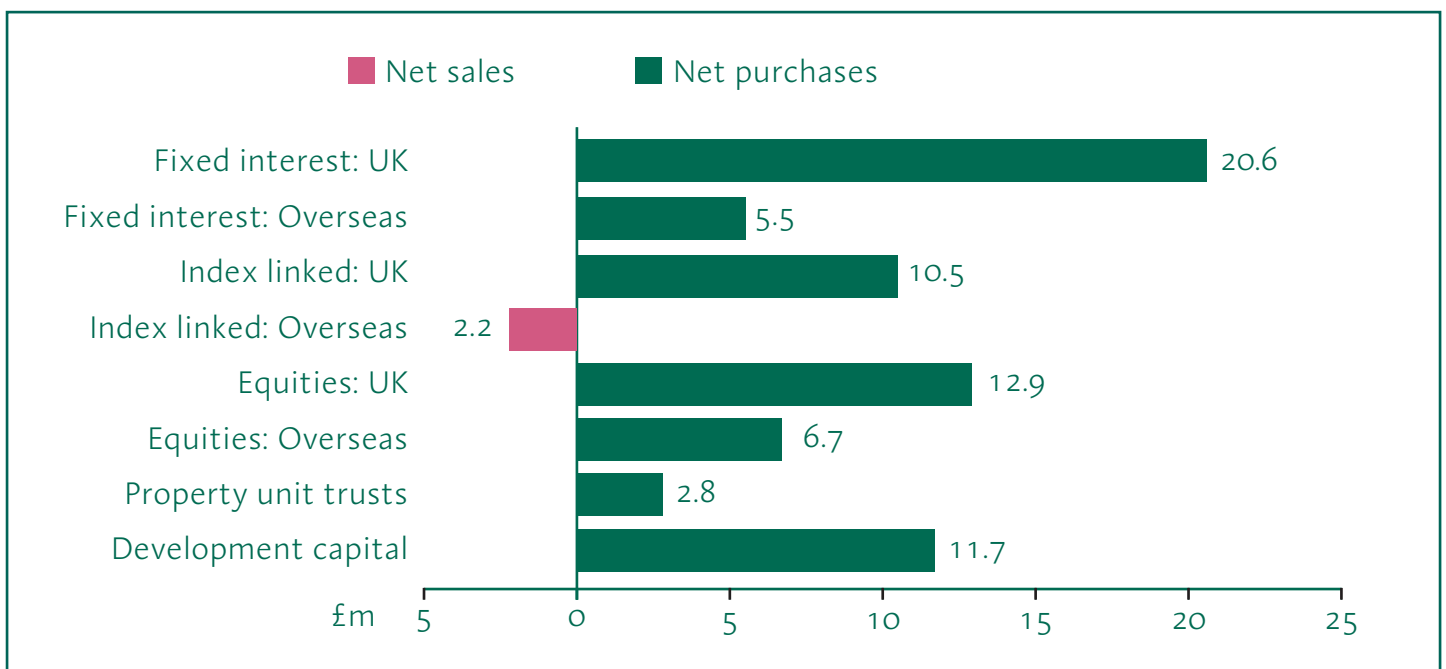
Investment distribution

The chart below shows how the Fund has been invested over the last five years.



Investment activity

The net investment activity during the year ended 31 March 2007 is reflected in the chart below.



Investment performance

The Fund participates in two investment performance measurement services that assess the rate of return achieved by the Fund and provide comparisons with the performance achieved by other pension funds. The Society of County Treasurers and the Chartered Institute of Public Finance and Accountancy, through the WM Company, provide one of these services, covering local authority pension funds. Surrey's global custodian Northern Trust provides the other service, measuring the Fund's

performance against the customised benchmark performance.

Performance against target and benchmark is continually reviewed at regular intervals, as stated in the Fund's Statement of Investment Principles.

The graph below shows how the Fund is performing over the short and longer-term periods in comparison to the WM Universe and the Surrey Benchmark.



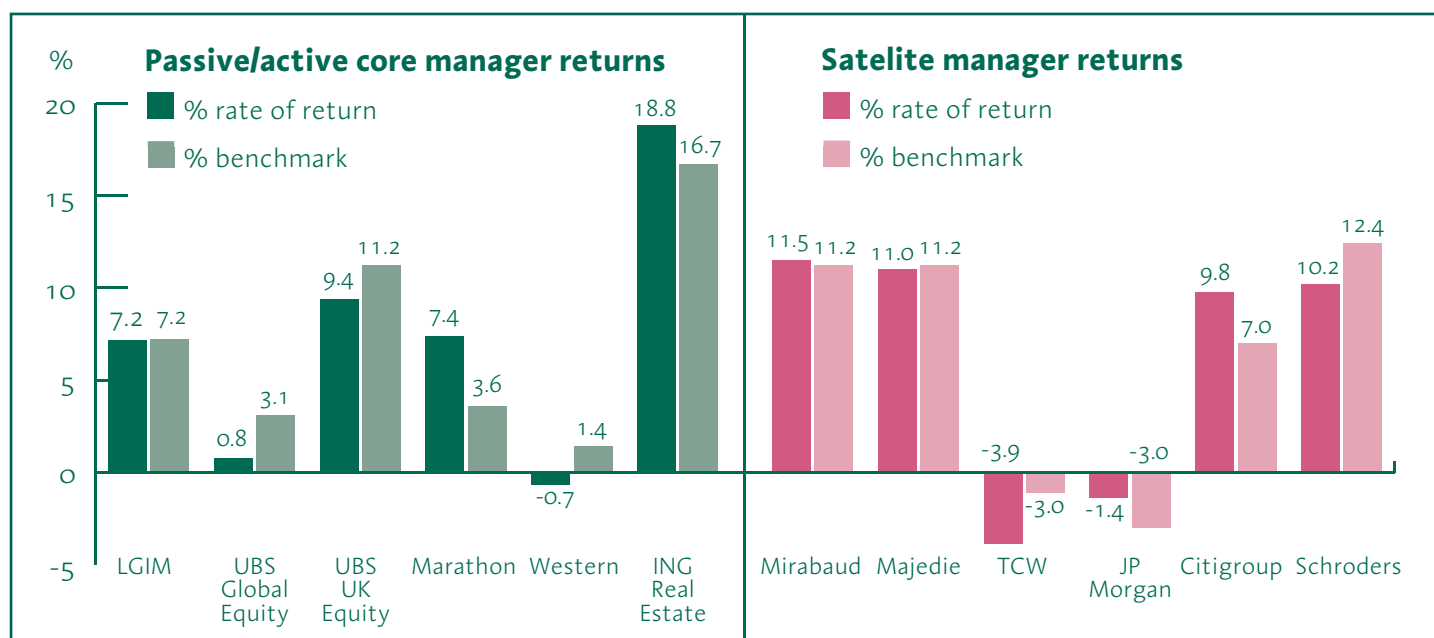
Annual returns over each of the last five years, and for three and five years were as follows:

Financial years	SCC (measured by Northern Trust) %	WM local authority universe %	Surrey benchmark %
2006-2007	7.0	7.0	7.0
2005-2006	24.9	24.8	26.3
2004-2005	11.6	11.7	11.5
2003-2004	25.5	23.9	23.3
2002-2003	-20.4	-20.1	-20.5
2004-2007 (3 year average)	14.4	14.3	14.6
2002-2007 (5 year average)	8.4	8.2	8.2

All the rates of return quoted take into account investment income as well as realised and unrealised capital profits or losses in the period. The Surrey benchmark figure for the 5-year period reflects both the current core-satellite approach and old balanced structure.

Annual returns for fund managers

The annual investment returns as at 31 March 2007 for each fund manager grouping, and by asset class, are shown below.



Pension fund performance measured by asset class for the year ended 31 March 2007

	Portfolio %	Index %
UK equities	10.9	11.1
Overseas equities		
North America	-0.1	-0.9
Europe	11.3	12.4
Japan	-7.5	-9.9
Pacific Basin	13.1	12.3
Emerging markets	9.8	7.0
UK fixed interest		
Gilts	0.5	0.6
Non-Gilts	1.3	0.8
Overseas bonds	-3.5	-5.1
Index linked	3.0	3.0
Property	19.0	16.6
Total fund	7.0	7.0

Report of the Actuary

Report of the Actuary for the year ended 31 March 2007

As required by Regulation 77 of the Local Government Pension Scheme Regulations 1997, an actuarial valuation of Surrey Pension Fund's assets and liabilities was carried out as at 31 March 2004.

Security of prospective rights

In my opinion, the resources of the Fund are likely in the normal course of events to meet the liabilities of the Fund as required by the Regulations. In giving this opinion, I have assumed that the following amounts will be paid to the Fund:

- Contributions by the members in accordance with the Local Government Pension Scheme Regulations 1997 at the rate of 6% of pensionable pay for all members except manual staff who joined before 1 April 1998 who contribute at the rate of 5% of pensionable pay
- Contributions, for the three years commencing 1 April 2005, by the employers as specified in our Rates and Adjustments certificate dated 22 March 2005.

Summary of methods and assumptions used

Full details of the method and assumptions are described in our valuation report dated March 2005 and the Rates and Adjustments certificate contained therein.

Copies of these documents are available on

request from the Finance Department of Surrey County Council.

My opinion on the security of the prospective rights is based on:

- the projected unit valuation method where there is an expectation that new employees will be allowed to join an employer; or
- the attained age valuation method for employers who were closed to new entrants.

These methods assess the cost of benefits accruing to existing members during:

- the year following the valuation; or
- the remaining working lifetime, respectively allowing for future salary increases. The resulting contribution rate is adjusted to allow for any difference in the value of accrued liabilities and the assessed value of assets.

Valuation of assets

A "market related" valuation method has been used. However, in the previous valuation, a "smoothed" approach was taken for deriving the financial assumptions and assessing the value of assets. At the 2004 valuation, such a smoothing methodology was not used to devise the financial assumption – spot yields were used instead. Nor was any smoothing used in assessing the asset values.

Valuation assumptions

The key financial assumptions adopted at the 2004 valuation are set out in the table below:

Financial assumptions	March 2004 unsmoothed	
	% p.a. nominal	% p.a. real
Discount rate	6.3%	3.4%
Pay increases	4.4%	1.5%
Price inflation/pension increases	2.9%	-

The 2004 valuation revealed that the Fund's assets, which at 31 March 2004 were valued at £1,107 million, were sufficient to meet approximately 68% of the liabilities accrued up to that date.

Individual employer's contributions have been set in accordance with the Fund's funding strategy statement. The deficit for each individual employer is being spread over a period up to a maximum of 20 years. Any increases in contribution rates from 31 March 2005 are being phased in over a period of up to three years.

Forthcoming actuarial valuation

The next valuation of the Fund will be carried out as at 31 March 2007 and the results known later that year. This valuation will allow for the experience of the Fund since 31 March 2004 and up-to-date financial assumptions at that time.

My opinion on the security of prospective rights is dependant upon any increased contribution requirements being met by the employers. This statement should be read in the context of the statutory nature of the scheme.

Prepared by:



Bryan Chalmers FFA

14 June 2007

For and on behalf of Hymans Robertson LLP

Statement of Accounts

Statement of responsibilities and certification of accounts

The responsibilities of the County Council

The County Council is required:

- to make arrangements for the proper administration of the financial affairs of the Fund and to secure that one of its officers has the responsibility for the administration of those affairs. In this Authority, that officer is the Head of Finance.
- to manage the Fund's affairs to secure economic, efficient and effective use of resources and safeguard its assets; and
- to approve the statement of accounts.

The responsibilities of the Head of Finance

The Head of Finance is responsible for the preparation of the Fund's statement of accounts in accordance with proper practices as set out in the CIPFA/LASAAC code of practice on local authority accounting in Great Britain ("the code of practice").

In preparing this statement of accounts, the Head of Finance has:

- selected suitable accounting policies and then applied them consistently;
- made judgements and estimates that were reasonable and prudent;
- complied with the code of practice;

The Head of Finance has also:

- kept proper accounting records which were up to date;
- taken reasonable steps for the prevention and detection of fraud and other irregularities.

Accounting policies

Accounting standards

The accounts have been prepared to meet the requirements of the Local Government Pension Scheme Regulations 1997 and in accordance with the Statement of Recommended Practice (SORP), "Financial Reports of Pension Schemes".

Actuarial position

The accounts summarise the transactions of the Scheme and deal with the net assets. They do not take account of liabilities to pay pensions and other benefits in the future. They should therefore be read in conjunction with the actuarial position on page 20, which takes such liabilities into account.

Contributions, benefits and transfer values

- Contributions and benefits are included on an accruals basis.
- Transfer values are accounted for on a cash basis apart from bulk transfers, which are accrued at year end. No allowance is made for further outstanding transfer values because of uncertainty arising from the options available to transferred staff.

Investments are included in the accounts at market value. The basis of determining market values is described below:

- All UK securities traded within SETS (Stock Exchange Electronic Trading Service) are valued using last SETS traded price. All other UK securities are valued on the basis of middle market prices at close of business on the last trading day of the financial year.
- Unlisted securities are valued having due regard to latest dealings, professional valuation, asset values and other appropriate financial information.

- Overseas securities are valued on overseas stock exchange quotations at close of business on the last day of the financial year.
- Property and other unit trusts are valued at the unit trust managers' valuations.
- The sterling values of overseas securities have been assessed on the currency exchange rates ruling on the last trading day of the financial year.

Investment income

Interest and dividends due but not received on holdings quoted ex-dividend at 31 March 2007 have been accrued and included as investment income.

Taxation

• Investments

The Fund is exempt from UK income tax on interest received and from capital gains tax on the proceeds of investments sold. Income from overseas investments suffers a withholding tax in the country of origin, unless exemption is permitted as in the United States and Australia. Tax deducted in some European countries is recovered.

• VAT

All VAT paid is recoverable, and is accounted for through the County Fund.

Administrative expenses

- Pensions administrative expenses reflect the costs incurred in the payment of pensions and other benefits, actuarial advice, dealing with transfer values and the maintenance of member records. Employer related costs are excluded.
- Investment management expenses include fees to the investment managers, the custodian, the actuary for investment related services and the performance measurement services together with the County Council costs incurred on administration and monitoring of investment related issues.

Fund account for the year ended 31 March 2007

	Note	2007 £000	2006 £000
Contributions and benefits			
Contributions receivable	1	108,805	103,281
Transfers in		<u>12,127</u>	<u>18,765</u>
		120,932	122,046
Benefits payable	2	79,731	68,143
Leavers	3	11,515	12,075
Administrative expenses		<u>1,176</u>	<u>1,175</u>
		92,422	81,393
Net additions from dealings with members		28,510	40,653
Returns on Investments			
Investment income	5	35,141	32,029
Change in market value of investments		76,770	281,492
Investment management expenses	4	(4,541)	(4,129)
Net returns on investments		107,370	309,392
Net increase (decrease) in the Fund during the year		135,882	350,045
Net assets of the Fund at 1 April		1,617,747	1,267,702
at 31 March		1,753,629	1,617,747

Statement of net assets as at 31 March 2007

	Note	2007 £000	2006 £000
Investment assets	14		
Fixed interest securities		270,331	254,859
Index linked securities		36,852	28,088
Equities		1,266,712	1,173,042
Property unit trusts		109,474	92,833
Private equity		25,598	13,784
Cash		36,180	45,941
		<u>1,745,147</u>	<u>1,608,547</u>
Net current assets	6	8,482	9,200
Net assets of the Fund at 31 March		1,753,629	1,617,747

I certify that the statement of accounts presents fairly the financial position of the Pension Fund at 31 March 2007 and the amount and disposition at that date of its assets and liabilities, other than liabilities to pay pensions and benefits after that date.



Philip Walker
Head of Finance
November 2007

Notes to the statement of accounts

	2006/2007 £000	2005/2006 £000
1 Contributions receivable		
Employees' basic		
Administering authority	12,360	12,701
Scheduled bodies	10,657	9,393
Admitted bodies	2,092	2,162
Employees' additional		
Administering authority	33	154
Scheduled bodies	150	111
Admitted bodies	37	36
Employers' basic		
Administering authority	41,080	41,693
Scheduled bodies	31,985	27,381
Admitted bodies	5,895	6,104
Employers' additional		
Administering authority	2,256	1,992
Scheduled bodies	1,731	817
Admitted bodies	528	737
	<u>108,804</u>	<u>103,281</u>
2 Benefits payable		
Retired employees pensions		
Administering authority	27,100	24,581
Other scheduled and admitted bodies	27,849	26,165
Lump sums		
Administering authority	9,745	5,709
Other scheduled and admitted bodies	7,298	4,221
Death grants		
Administering authority	665	752
Other scheduled and admitted bodies	845	663
Widows' pensions		
Administering authority	2,601	2,511
Other scheduled and admitted bodies	3,387	3,260
Children's pensions		
Administering authority	83	150
Other Scheduled and admitted bodies	73	57
Total*	<u>79,646</u>	<u>68,069</u>

* Note the total does not include interest on late payment of benefits £84,024.

	2006/2007 £000	2005/2006 £000
3 Leavers		
Transfers	11,476	11,895
Refunds of contributions	47	153
State scheme premiums	-8	27
	<u>11,515</u>	<u>12,075</u>
4 Investment management		
Investment management and custodial fees	4,186	3,907
Actuarial, performance measurement and legal fees	151	68
Internal administration and accounting	204	154
	<u>4,541</u>	<u>4,129</u>
5 Investment income		
Fixed interest		
UK	7,206	5,161
Overseas	2,618	2,820
Index linked		
UK	327	251
Overseas	93	241
Equities		
UK	16,258	16,191
Overseas	3,385	2,878
Property unit trusts	3,239	2,898
Private equity	402	
Cash	1,613	1,559
Underwriting commission	-	30
	<u>35,141</u>	<u>32,029</u>
6 Current assets and liabilities		
Debtors		
Investment income	6,397	7,156
Contributions	3,266	3,046
Benefits (including transfer values)	508	361
	<u>10,171</u>	<u>10,563</u>
Creditors		
Benefits (including transfer values)	279	230
Inland revenue	435	33
Investment expenses	975	1,100
	<u>1,689</u>	<u>1,363</u>

7 Unlisted securities

The value of unlisted securities in the Fund at 31 March 2007 is £25,857,874 (31 March 2006 is £13,784,214).

8 Outstanding commitments

At 31 March 2007 the Fund held part paid investments on which the liability for future calls amounted to £63,548,751. The Fund had no sub-underwriting commitments as at 31 March 2007.

9 Forward currency contracts

At 31 March 2007 the Fund had forward currency contracts in place with a net unrealised loss of £249,842.

10 Additional voluntary contribution (AVC's)

AVC's are paid to Prudential Life Assurance with a small number still being paid to Equitable Life. AVC's are not included in the accounts of the pension fund.

11 Book cost

The book cost of all investments at 31 March 2007 is £1,382,366,283 (£1,264,062,909 at 31 March 2006).

12 Custody

Custody arrangements for securities and cash balances are provided by Surrey's Global Custodian, The Northern Trust Company. Custodian arrangements for the managers responsible for private equity are as follows:

ISIS Equity Partners	RBS Trust Bank
Goldman Sachs	Investors Bank & Trust Company
HG Capital	Bank of New York
Blackrock	Mellon Bank
Standard Life	Banques Paribus

13 Related party transactions

Employer pension contributions paid by Surrey County Council in 2006/2007 amounted to were £43,336,797 (£43,082,436 in 2005/2006):

Employers future service contributions	£23.8m
Annual monetary amount	£17.2m
Early retirement liabilities	£2.3m

Net amounts owed by Surrey County Council to the Fund as at 31 March 2007 were £22,509,323 (£18,825,877 as at 31 March 2006).

	Value at 1 April 06 £000	Purchases at cost £000	Sale proceeds £000	Market movements £000	Value at 31 March 07 £000
14 Investments					
Fixed Interest Securities	254,859	101,867	(75,792)	(10,603)	270,331
Index Linked Securities	28,088	13,825	(5,496)	435	36,852
Equities	1,173,042	188,609	(169,015)	74,075	1,266,712
Property Unit Trusts	92,833	29,343	(26,544)	13,842	109,474
Private Equity	13,784	17,057	(5,351)	108	25,598
Cash	45,941		(8,673)	(1,088)	36,180
	<u>1,608,547</u>	<u>350,701</u>	<u>(290,871)</u>	<u>76,770</u>	<u>1,745,147</u>

The change in market value of investments during the year comprises all increases and decreases in the market value of investments held at any time during the year, including profits and losses realised on sales of investments during the year.

	2006/2007 £000	2005/2006 £000
14.1 Fixed interest securities		
UK public sector & quoted	137,416	112,776
UK unit trusts	44,864	57,265
Overseas public sector & quoted	62,700	62,590
Overseas unit trusts	25,351	22,228
	<u>270,331</u>	<u>254,859</u>
14.2 Index linked securities		
UK public sector & quoted	22,094	11,182
UK unit trusts	12,259	11,902
Overseas public sector	2,499	5,004
	<u>36,852</u>	<u>28,088</u>
14.3 Equities		
UK quoted	344,589	481,244
UK unit trusts	411,898	204,494
Overseas quoted	220,140	217,840
Overseas unit trusts	290,085	269,464
	<u>1,266,712</u>	<u>1,173,042</u>
14.4 UK Property unit trusts	109,474	92,833
14.5 Private equity		
UK unquoted	5,823	3,429
UK unit trusts	19,775	10,355
	<u>25,598</u>	<u>13,784</u>
14.6 Cash		
Sterling deposits	36,918	51,051
Amounts owed to brokers	-489	(4,326)
Foreign currency	-	-
Forward contracts	-249	(784)
	<u>36,180</u>	<u>45,941</u>
Total investments	1,745,147	1,608,547

15 Post balance sheet events

There have been no material post balance sheet events.

Appendix 1 – the Fund’s largest shareholdings

	Market value at 31/03/2007 £m
Top 10 United Kingdom equities	
BP PLC	27.9
Vodafone Group	17.7
Royal Bank of Scotland	13.4
GlaxoSmithKline	21.5
Tesco	11.0
HSBC	12.7
Royal Dutch Shell	16.3
Barclays	16.0
HBOS	9.8
Prudential	9.5
Wolsey	5.4
	<u>161.2</u>
Top 10 overseas equities	
Sumitomo	4.4
Jardine Matheson	4.0
Tokyo Electric Power	2.2
Costco Whsl Corp	2.2
New World	2.0
West Japan	1.9
Halliburton	1.9
Telefonica	1.9
Noble Corporation	1.7
Mitsubishi UFJ	1.7
	<u>23.9</u>
Top 5 unit trusts	
Legal & General UK Equity	391.3
UBS Asset Life Global Optimal	69.6
Legg Mason Emerging Markets	59.3
Schroder Retail European	55.0
Legal & General AAA-AA-A Fixed Interest All Stocks	33.0
	<u>608.2</u>
	793.3

These holdings make up 45% of the total value of the portfolio.

Appendix 2 – Scheduled bodies and contribution rates payable in 2006/2007

Scheduled bodies	% of payroll	% of members' contributions	Annual monetary amount £
Administering authority Surrey County Council inc. schools	11.6	193	17,456,000
Borough and District Councils			
Elmbridge Borough Council	11.7	195	707,000
Epsom & Ewell Borough Council	12.5	208	610,000
Guildford Borough Council	11.3	188	1,704,000
Mole Valley District Council	12.1	201	542,000
Reigate & Banstead Borough Council	12.0	200	1,076,000
Runnymede Borough Council	12.5	208	230,000
Spelthorne Borough Council	12.3	205	314,000
Surrey Heath Borough Council	12.8	213	259,000
Tandridge District Council	12.6	210	1,004,000
Waverley Borough Council	13.0	216	1,006,000
Woking Borough Council	11.6	193	1,535,00
Parish and Town Councils			
Ash Parish Council	14.6	243	21,635
Bramley Parish Council	14.6	243	497
Bisley Parish Council	14.6	243	-
Claygate Parish Council	12.0	200	43
Cranleigh Parish Council	14.6	243	10,729
East Horsley Parish Council	13.9	231	-
Farnham Town Council	14.6	243	10,086
Frensham Parish Council	12.0	200	151
Godalming Town Council	14.6	243	9260
Godstone Parish Council	12.9	215	-
Haslemere Town Council	12.0	200	40
Horley Town Council	14.6	243	8,129
Ripley Parish Council	14.6	243	855
Send Parish Council	14.6	243	755
Shere Parish Council	14.6	243	1,826
Tongham Parish Council	14.6	243	168
Warlingham Parish Council	10.2	170	-
West End Parish Council	12.0	200	38
Windlesham Parish Council	14.6	243	3,231
Witley Parish Council	14.6	243	2,038
Worplesdon Parish Council	12.0	200	258

Scheduled bodies	% of payroll	% of members' contributions	Annual monetary amount £
Other authorities			
The Surrey Police Authority	10.1	168	972,000
Statutory committees			
Surrey Probation Committee	11.1	185	265,000
Surrey Valuation Tribunal	7.9	132	4,176
Further education establishments			
Brooklands College	17.0	283	-
East Surrey College	17.1	285	-
Esher College	14.1	235	-
Farnham College	14.1	235	-
Godalming College	14.1	235	-
Guildford College	16.5	275	-
NESCOT	17.0	283	-
Reigate College	14.1	235	-
Spelthorne College	14.1	235	-
Strode's College	14.1	235	-
The University College for Creative Arts	14.8	247	-
Woking College	14.1	235	-
Former grant maintained schools	21.4	356	-
Joint boards or joint committees			
Epsom & Walton Downs Conservators	14.6	243	17,587
Merton & Sutton Joint Cemetery Board	14.6	243	16,200
Nonsuch Park Joint Management Committee	14.6	243	18,765

Appendix 3 – Admitted bodies and contribution rates payable in 2006/2007

Admitted bodies	% of payroll	% of members' contributions
With contributing employees		
Az Housing Group	35.6	593
Carillion	15.5	258
Elmbridge Housing Trust	14.3	238
G Burley & Sons	11.8	197
Hanover Housing Association	16.4	273
John Stanley Jeffries Swimming Pool Trust	23.0	383
Moor House School	15.8	263
Commission for Social Care Inspection	17.3	288
Peerless Housing Group	23.4	390
Peper Harow Foundation (Thornby Hall)	53.4	890
Princess Alice Hospice	23.0	383
Reigate Grammar School	23.0	383
Raven Housing Trust	15.6	260
Ringway Highway Services Ltd	16.6	277
Rosebery Housing Association	23.0	383
Royal Grammar School, Guildford	23.0	383
SERCO	9.9	165
Sir William Perkins's School	23.0	383
Surrey Alcohol and Drug Advisory Service	11.6	193
Surrey Community Development Trust	12.2	203
Surrey Voluntary Association for Visual Impairment	23.0	383
Surrey Wildlife Trust	13.7	228
University of Surrey	17.9	298
VT Four S	11.6	193
Waverley Community Transport	11.4	190
Woking Community Transport	23.0	383

Without contributing employees		
East Surrey Water Company	North Surrey Water Company	Spelthorne Housing Assn
Godalming Joint Burial Committee	Nut Prob HM (Rainer)	Surrey Police committee
Haslemere SC/Shottermill	Peper Harow School	The Royal School, Hindhead
Lingfield HPL School	Royal Philanthropic SC	WESCAD
Meath Homes	South East Regional Arts	West Surrey Waterboard
Mid Southern Water	Shalford Parish Council	Woking Meals Service
	Southlands College	

Appendix 4 – Funding Strategy Statement

Introduction: Purpose of the Funding Strategy Statement

- 1 The Local Government Pension Scheme (England and Wales) (Amendment) Regulations 2004 came into effect on 1 April 2004. The Regulations provide the statutory framework within which LGPS administering authorities were required to prepare a Funding Strategy Statement (FSS) by 31 March 2005.
- 2 The purpose of the Funding strategy is:
 - to establish a clear and transparent fund-specific strategy, which will identify how employers' pension liabilities are best met going forward
 - to support the regulatory requirement to maintain as nearly constant employer contribution rates as possible; and
 - to take a prudent longer-term view of funding those liabilities.
- 3 The intention is for this strategy to be both cohesive and comprehensive for the Fund as a whole, recognising that there will be conflicting objectives that need to be balanced and reconciled. Whilst the position of individual employers must be reflected in the FSS, it must remain a single strategy for the administering authority to implement and maintain.
- 4 As administering authority of the Surrey LGPS, Surrey County Council addressed the key requirement of consulting with all relevant interested parties involved with the Pension Fund – for example, local authority employers; admitted bodies; scheduled/resolution bodies – before preparing and publishing the Pension Fund funding strategy.
- 5 This FSS should be read in conjunction with the County Council's report on the outcome of the 2004 actuarial valuation.

Background to the Surrey Pension Fund

- 6 The total value of the Pension Fund, as at 31 March 2005, was £1.3bn and in 2004/2005 employer contributions into the pension fund amounted to £67m.
- 7 There are over 100 employers involved in the Surrey Pension Fund. The largest employers, in terms of the number of active members and monetary contributions to the pension fund, are Surrey County Council, the Borough and District Councils, Surrey Police Authority and the University of Surrey.
- 8 The level of contributions into the Fund to be paid by each employer is determined by the triennial actuarial valuation. The 2004 actuarial valuation determined the level of contributions to be paid by employers during the period 1 April 2005 to 31 March 2008. The draft results of the valuation were received at the beginning of December 2004, allowing employers to incorporate any changes in contribution rates into the budget setting process for 2005/2006.

The aims and purpose of the pension fund

- 9 The aims of the Fund are to:
 - enable employer contribution rates to be kept as nearly constant as possible and at reasonable cost to the taxpayers, scheduled, resolution and admitted bodies
 - manage employers' liabilities effectively
 - ensure that sufficient resources are available to meet all liabilities as they fall due
 - maximise the returns from investments within reasonable risk parameters.

10 The purpose of the Fund is to:

- receive monies in respect of contributions, transfer values and investment income, and
- pay out monies in respect of scheme benefits, transfer values, costs, charges and expenses,

as defined in the Local Government Pension Scheme Regulations and in the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 (as amended).

Responsibilities of key parties

11 Surrey County Council, as administering authority, will:

- collect employee and employer contributions
- invest surplus monies in accordance with the relevant regulations
- ensure that cash is available to meet liabilities as and when they fall due
- manage the actuarial valuation process in consultation with Hymans Robertson, the fund actuary
- prepare and maintain a Funding Strategy Statement (FSS) and a Statement of Investment Principles (SIP), both after proper consultation with interested parties, and
- monitor all aspects of the Fund's performance and funding and amend the FSS/SIP as appropriate.

12 Individual employers in the Fund will:

- deduct contributions from employees' pay correctly
- pay all contributions, including their own as determined by Hymans Robertson, promptly by the due date

- exercise discretions within the regulatory framework
- make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of scheme benefits and early retirement strain, and
- notify Surrey County Council promptly of all changes to membership, or as may be proposed, which affect future funding.

13 Hymans Robertson, the Fund actuary, will:

- prepare actuarial valuations, including the setting of employers' contribution rates after agreeing assumptions with the administering authority and having regard to the FSS, and
- prepare advice and calculations in connection with bulk transfers and individual benefit-related matters.

Solvency issues and target funding levels

14 Surrey County Council, as administering authority, prudentially seeks to achieve full funding.

Background

- 15** For many years up to 1989, legislation required that the Fund was adequate to meet all liabilities, i.e. was 100% solvent. In 1989 the regulations in force specified that the target level of funding need only be 75% of future liabilities, thereby leading to a reduction in costs that was intended to offset the impact of the new community charge system.
- 16** A further complexity arose in 1990 following the 1989 review. Prior to that year the employers' contribution had been set in two parts.
- i A rate was set to provide for the basic benefits of the Scheme through the Fund

- ii A further rate was set to meet the cost of pensions increases and other non-statutory benefits on a “pay as you go” basis. Pensions increases are the annual uprating of pensions in payment for cost of living.
- 17** Following the implementation of new regulations from 1 April 1990, the cost of inflation proofing both pensions payments and deferred benefits was incorporated within the overall fund and met through a single employers’ contribution rate. This change resulted in a reduction in the solvency level and also to an overall reduction in employers’ contributions.
- 18** Regulations issued by the department of the Environment in 1992 specified a return to the former target funding level of 100%. The consequence of the regulation is that, since April 1993, those employers with an excess of liabilities over assets (“past service deficiency”) have been paying additional contributions into the Fund in order to return to 100% solvency over the remaining working lifetime of the members of the Fund (an average of 13 years).
- 19** The last actuarial valuation, as at 31 March 2001, determined that the Fund was 75% funded, i.e. that the assets of the Fund were sufficient to cover 75% of its liabilities. The reasons behind this funding level include those issues mentioned above, together with a change in the tax treatment of pension funds in 1997, which removed the ability for funds to claim credits on tax paid on dividends. This government policy change reduced the funding level of the Surrey Fund by around 8%.
- 20** The overall funding level remained broadly unchanged over the three year inter-valuation period (1998 – 2001), mainly because poor investment performance relative to the 1998 valuation assumptions offset the contributions being made toward the deficiency.
- The 2004 Actuarial Valuation**
- 21** During summer 2004 Surrey County Council had preliminary discussions with Hymans Robertson, to establish ways of responding to the likely outcome of the 2004 actuarial valuation. Early indications were that the whole fund funding level would reduce, leading to an increase in lump sum payments into the Fund. However, ongoing contribution rates were expected to be relatively stable, given the recent changes in the regulations governing the application of the LGPS.
- 22** A number of ways of mitigating the impact of these results on employers were identified including:
- increasing the length of time over which fund deficits will be recovered
 - applying different spread period for different employers to reflect the funding level of each individual employer
 - applying different spread periods for different employers to reflect the funding status of each individual employer (i.e. whether or not the employer has tax raising powers)
 - changing the financial assumptions used within the valuation
 - changing the investment assumptions used within the valuation
 - changing the approach for ‘closed’ employers, i.e. those employers that are no longer accepting new members

- grouping certain employers to recognise common characteristics, e.g. size of membership.
- 23 The purpose of this FSS is to have full transparency regarding the options available to employers.
- 24 As administering authority, Surrey County Council recommends as consistent an approach as is possible. However, it is acknowledged that some employers have unique features that should be recognised

when setting the assumptions to be used in the actuarial valuation.

- 25 Ultimately, it remains Surrey County Council's intention to have as stable a long-term employer contribution rate as is possible.

The 2004 valuation results

- 26 The following table summarises the main results of the 2004 valuation:

	2001 Valuation	2004 Valuation
Active members		
Number of active members	20,510	22,100
Total annual pensionable pay	£290.5m	£434.4m
Average pensionable pay	£14,164	£19,656
Deferred pensions		
Number of deferred pensioners	10,079	14,656
Total annual value of deferred pensions payable in future	£15.0m	£20.9m
Pensioners and widow(er)s		
Number of pensioners	13,111	14,293
Total annual pensions payable	£48.3m	£53.3m
Average pension in payment	£3,684	£3,729
Value of liabilities	£1,317.0m	£1,623.0m
Market value of the Fund	£988.9m	£1,105.6m
Solvency level of the Fund	75.0%	68.0%

- 27 As expected, the solvency level of the Fund reduced to 68%. Consequently employer contribution rates had to increase.
- 28 The employer's contribution rate consists of two elements:
- i The ongoing rate, when following the 2001 actuarial valuation was 160% of employees' contributions, which provides the year-by-year accrual of benefits for current employees

ii A lump sum in respect of past service liabilities, currently £26.1m in 2004/2005 and estimated to increase by inflation.

29 Following discussions with the Fund Actuary, the following measures were adopted to mitigate the impact of the increase in contribution rates:

Ongoing rate

30 Allowance for the proposed abolition of the 'rule of 85'. This measure reduced future service contribution rates by 1.6%.

31 Allowance for the Fund's investment strategy and expected future returns on investments. the Fund's current asset allocation strategy was derived following an Asset-Liability Modelling (ALM) study of the Fund in the summer 2000. This resulted in a decision to invest 75% of the Fund in equities and 25% in fixed interest stocks and property. This new benchmark was implemented in November 2000.

32 Having analysed historic results and future projections of equity returns the Fund Actuary and the administering authority recommend that credit should be taken for the additional return that the Fund should generate due to being more heavily invested in equities. To ensure prudence it was assumed that this return will be 2% p.a. more than that which may be achieved if the Fund was invested solely in government bonds. This measure reduced future service contribution rates by 7.3% of payroll.

Lump sum rate

33 The second element of the contributions made by employing authorities is the contribution paid to liquidate the deficit on the pension fund. The 2004 valuation found

that the overall fund deficit increased from £328m to £516m. Historically the deficit has been recovered over the remaining working lifetime of active employees in the Fund . At the 2001 valuation this was determined to be 13 years. If the deficit continued to be spread over 13 years then the average annual employer contribution to liquidate the deficit would amount to 16.6% of payroll (giving a total employer contribution rate of 28.2% of payroll.)

34 However, given the abolition of the 'rule of 85' it was not unreasonable to increase the period over which the Fund deficit is recovered. The Actuary assessed that the average age of employees in the Fund is 44.4 years. Therefore each employee has a remaining working lifetime of around 20 years.

35 The Fund Actuary and the administering authority therefore recommended recovering the deficit over 20 years, resulting in an average past service adjustment of 8.9% of payroll (a reduction of 7.7% of payroll), to be expressed in monetary terms for the purpose of effective budgeting. Again lump sums paid by individual employers will vary depending on the size of the employer's share of the Pension Fund deficit. The total recommended average employer contribution rate (expressed as a percentage of payroll) therefore comprises:

a. Future service funding rate	11.6%
b. Past service adjustment	8.9%
c. TOTAL	20.5%

"Stepping" of Increases in Contributions

36 In 1995 it was agreed that, in order for the Fund to return to 100% solvency, the

employers could make stepped increases in contributions to fund past service liabilities. The steps were to be made over a 6-year period after which the annual contributions would be fixed at the final stepped rate determined by the actuary. There are a handful of employers that, despite the increase in the deficit recovery period and due to circumstances specific to each employer, saw a disproportionately large increase in lump sum payments to be made in 2005/2006 compared to the previous financial year. These employers were advised that it may be possible to adopt the 1995 stepping approach.

- 37 Those employers with less onerous increases in lump sum contributions were offered the opportunity to step their increase over the 3-year inter-valuation period. The administering authority, however, advised that any employer that chose to step the increases in contributions must be aware that they would be making smaller inroads into the overall deficit, which will be reflected in the 2007 actuarial valuation.

Consultation

- 38 The larger employers in the Fund were fully consulted on the approaches taken to mitigate the impact of the 2004 actuarial valuation. This consultation includes written communication and attendance at meetings of the Surrey Treasurers' Association.
- 39 The Borough and District Councils agreed individual approaches to spreading the impact of the increase in the relevant share of the Pension Fund deficit. Some employers chose to step the increase in lump sum payments, while others opted to implement the full rate in 2005/2006.

- 40 These employers have also agreed the blanket approach of taking into account the abolition of the rule of 85 and the adoption of a 2% Equity Risk Premium.

Links to the Fund's investment policy set out in the Statement of Investment Principles

- 41 The County Council is the designated statutory body responsible for administering the Surrey Pension Fund on behalf of the constituent scheduled and admitted bodies. The Council is responsible for setting investment policy, appointing suitable persons to implement that policy and carrying out regular reviews and monitoring of investments.
- 42 The Fund's Statement of Investment Principles is a formal statement of how the County Council carries out these responsibilities.
- 43 The Investment Advisers Group, having regard to funding levels, cash needs and risk tolerance, determines the overall fund asset mix. An Asset-Liability Modelling (ALM) study took place in 2000 and the resultant customised benchmark was implemented in November 2000. The 2006 ALM study confirmed the appropriateness of maintaining the Fund's asset allocation structure, albeit with a modified strategic benchmark. Implementation of the new benchmark and full fund structure review will conclude early in 2008 and will be reflected in a revised Statement of Investment Principles.

The Identification of risks and counter-measures

- 44 The County Council recognises that there are certain risks that may impact on this FSS. These risks and measures to be taken to counter these risks include:

Financial risks	Counter measures
Investment markets fail to perform in line with expectations	Do not over-estimate the equity risk premium adopted for the actuarial valuation
Market yields move at variance with assumptions	Apply sensitivity analysis to determine, in advance, the likely financial impact of a 1% deviance from expectations
Investment managers fail to achieve performance targets over the longer term	The Investment Management Agreement (between SCC and the Fund manager) clearly states the Customer's expectations in terms of performance targets. Investment manager performance is reviewed on a quarterly basis. The Investment Advisers Group is positioned to move quickly if it is felt that targets will not be met.
Asset reallocations in volatile markets may lock in past losses	The Fund's passive (index-tracking) manager rebalances the Fund's asset allocation on a monthly basis.
Pay and price inflation is significantly more or less than anticipated	Apply sensitivity analysis to determine, in advance, the likely financial impact of a 0.5% deviance from expectations
The effect of a possible increase in employer's contribution rate on service delivery and admitted/scheduled bodies	Apply different deficit recovery periods to reflect the financial standing of employers
Demographic risks	
The longevity horizon continues to expand	Hymans Robertson is using long-term longevity projections (30 years) in the 2004 actuarial valuation
Deteriorating pattern of early retirements	The cost of early retirements is recovered from employers as and when they occur
The impact of government policy (e.g. The Gershon review) on the employer workforce	Hymans Robertson will make prudent assumptions about the future local government workforce, under the guidance of the administering authority.

Regulatory risks	
Changes to LGPS regulations	Hymans Robertson will take into account the impact of the Local Government Pension Scheme (Amendment) Regulations 2004 in the actuarial valuation.
Changes to national pensions requirements and/or Inland Revenue rules	Kept under continual review.
Governance	
Administering authority unaware of structural changes in an employer's membership	Employers are required to inform Surrey County Council of any significant changes in membership numbers on a timely basis. Surrey County Council monitors employer contributions on a monthly basis and queries any obvious variations. Employers are required to produce a year-end report on membership numbers. The County Council carries out in depth movement analysis on an annual basis.
Administering authority not advised of an employer closing to new entrants	This is only relevant to employers with an admission agreement (scheduled and resolution bodies cannot close the scheme to new entrants). It is a requirement of the admission agreement that Surrey County Council is informed if the employer closes to new members
An employer ceasing to exist with insufficient funding or adequacy of a bond	Admitted body contribution rates are set at a level that is intended to reflect 100% funding. The terms of a bond provide for regular review of the adequacy of a bond.

Consultation and publication

45 The larger employers in the Surrey Pension Fund were fully consulted on the approaches taken to mitigate the impact of the 2004 Actuarial Valuation.

The major employers were also asked to approve the first draft of the FSS. This statement will be reviewed as part of the 2007 Actuarial Valuation process.

Myners Investment Principles- Compliance Statement

Statutory Instrument 2002 No. 1852 requires that Surrey County Council, administering authority of the Surrey Pension Fund, publish details of the extent to which the Fund complies with the ten principles identified as indicators of best practice in the Myners Review of Institutional Investment. The following summarises these principles and explains how Surrey County Council has complied with the principles. Further information is available in the Statement of Investment Principles.

Principle 1

Effective decision-making

Decisions should be taken only by persons or organisations with the skills, information and resources necessary to take them effectively. Where trustees elect to take investment decisions, they must have sufficient expertise and appropriate training to be able to evaluate critically any advise they take.

Trustees should ensure that they have sufficient in-house staff to support them in their investment responsibilities. Trustees should also be paid, unless there are specific reasons to the contrary.

It is good practice for trustee boards to have an investment sub-committee to provide the appropriate focus.

Trustees should assess whether they have the right set of skills, both individually and collectively, and the right structures and processes to carry out their role effectively. They should draw up a forward-looking business plan.

✓ Full compliance – a rolling programme of training is in place for the Investment Advisers Group. The group is supported by the Head of Finance, the Pension Fund and Treasury Manager.

Principle 2

Clear objectives

Trustees should set out an overall investment objective for the Fund that:

- Represents their best judgement of what is necessary to meet the Fund's liabilities given their understanding of the contributions likely to be received from employer(s) and employees; and
- Takes account of their attitude to risk, specifically their willingness to accept underperformance due to market conditions.

Objectives for the overall fund should not be expressed in terms which have no relationship to the Fund's liabilities, such as performance relative to other pension funds, or to a market index.

✓ Full compliance – the Fund's overall objectives are defined in a Funding Strategy Statement and are directly linked to the findings of the triennial actuarial valuation. The investment objectives are clearly stated in the Statement of Investment Principles and were reviewed as part of the 2006 Asset Liability Modelling study (ALM).

Principle 3

Focus on asset allocation

Strategic asset allocation decisions should receive a level of attention (and, where relevant,

advisory or management fees) that fully reflects the contribution they can make towards achieving the Fund's investment objective.

Decision-makers should consider a full range of investment opportunities, not excluding from consideration any major asset class, including private equity.

Asset allocation should reflect the Fund's own characteristics, not the average allocation of other funds.

✓ **Full compliance – a customised benchmark has been in place since 2000 and will be reviewed as part of the 2006 ALM Study. The Fund continues to invest in private equity.**

Principle 4

Expert advice

Contracts for actuarial services and investment advice should be opened to separate competition.

The Fund should be prepared to pay sufficient fees for each service to attract a broad range of kinds of potential providers.

✓ **Full compliance – the Fund has separate actuarial and professional investment advisers.**

Principle 5

Explicit mandates

Trustees should agree with both internal and external investment managers an explicit written mandate covering agreement between trustees and managers on:

- an objective, benchmark(s) and risk parameters that together with all other

mandates are coherent with the Fund's aggregate objectives and risk tolerances

- the manager's approach in attempting to achieve the objective; and
- clear timescale(s) of measurement and evaluation, such that the mandate will not be terminated before the expiry of the evaluation timescale for underperformance alone.

The mandate and trust deed and rules should not exclude the use of any set of financial instruments, without clear justification in the light of the specific circumstances of the Fund.

Trustees, or those to whom they have delegated the task, should have a full understanding of the transaction-related costs they incur, including commissions. They should understand all the options open to them in respect of these costs, and should have an active strategy – whether through direct financial incentives or otherwise – for ensuring that these costs are properly controlled without jeopardising the Fund's other objectives.

Trustees should not without good reason permit soft commissions to be paid in respect of their fund's transactions.

✓ **Full compliance – the investment management agreements that were put in place in 2004 (following the appointment of new fund managers) clearly state each manager's objectives and parameters within which they are able to work to meet their objectives. Transaction costs are disclosed by the Fund managers in line with industry best practice, and are monitored on a quarterly basis.**

Principle 6

Activism

The mandate and trust deed should incorporate the principle of the US department of Labor Interpretative Bulletin on activism.

Trustees should also ensure that managers have an explicit strategy, elucidating the circumstances in which they will intervene in a company; the approach they will use in doing so; and how they measure the effectiveness of this strategy.

- ✓ **Partially compliant** – the Statement of Investment Principles sets out the Fund’s approach to corporate governance. Fund managers are expected to engage with companies in which they invest on the Fund’s behalf and have delegated authority to exercise the Fund’s voting rights.

Principle 7

Appropriate benchmarks

Trustees should explicitly consider, in consultation with their investment manager(s), whether the index benchmarks they have selected are appropriate; in particular, whether the construction of the index creates incentives to follow sub-optimal investment strategies;

- if setting limits on divergence from the index, ensure that they reflect the approximations involved in index construction and selection;
- consider explicitly for each asset class invested, whether active or passive management would be more appropriate given the efficiency, liquidity and level of transaction costs in the market concerned; and

- where they believe active management has the potential to achieve higher returns, set both targets and risk controls that reflect this, giving the managers the freedom to pursue genuinely active strategies.

- ✓ **Full compliance** – customised benchmark and tolerance ranges for divergence from indices are constantly under review and subject to discussion between the Council, investment advisers and fund managers. Specialist managers have been appointed to maximise returns in each active asset class and outperformance targets reflect the risk/return requirements of both the Fund as a whole and the individual managers.

Principle 8

Performance Measurement

Trustees should arrange for measurement of the performance of the Fund and make formal assessment of their own procedures and decisions as trustees.

They should also arrange for a formal assessment of performance and decision-making delegated to advisers and managers

- ✓ **Full compliance** – each manager’s performance is measured regularly against targets which are specified in the contract between SCC and the manager. Northern Trust, the Fund’s global custodian, produces performance data for each manager and for the Fund as a whole. The target outperformance for the Fund as a whole is specified within the Statement of Investment Principles. The Fund performance is also assessed with reference to the local authority peer group.

Principle 9

Transparency

A strengthened Statement of Investment Principles should set out:

- who is taking which decisions and why this structure has been selected
- the Fund's investment objective
- the Fund's planned asset allocation strategy, including projected investment returns on each asset class, and how the strategy has been arrived at
- the mandates given to all advisers and managers; and
- the nature of the fee structures in place for all advisers and managers, and why this set of structures has been selected.

✓ Full compliance – the current SIP, read in conjunction with the Funding Strategy Statement, describes the arrangements that were put in place when new managers were appointed in 2004. Further details are included in the Fund's annual report and at the Pension Fund AGM.

Principle 10

Regular reporting

Trustees should publish their Statement of Investment Principles and the results of their monitoring of advisers and managers.

They should send key information from these annually to members of these funds, including an explanation of why the Fund has chosen to depart from any of these principles.

✓ Full compliance – pensions newsletters are sent to fund members and include summarised Pension Fund accounts. The SIP is published in the annual report, which is sent to employers and available to other stakeholders on request. The County Council's Audit and Governance Committee receives reports on the activities of the Investment Advisers Group. These reports are available on the County Council website.

Statement of Investment Principles

1 Overall responsibility

The County Council is the designated statutory body responsible for administering the Surrey Pension Fund on behalf of the constituent scheduled and admitted bodies. The Council is responsible for setting investment policy, appointing suitable persons to implement that policy and carrying out regular reviews and monitoring of investments. The content of this statement reflects the County Council’s compliance with the requirements of the Myners Review of Institutional Investment.

Investment policy and associated monitoring and review are delegated to the Head of Finance who exercises the power to invest the Fund’s monies in consultation with the Investment Advisers Group, which is made up of:

- four nominated members of the County Council
- two representatives from the District Councils nominated by the SLGA
- a representative of the members of the Fund
- a representative of the Fund’s professional investment adviser
- an independent adviser
- the Head of Finance.

The Advisers meet quarterly and make a report to the County’s Audit & Governance Committee. The Advisers are not trustees (technically the

Department for Communities and Local Government is the trustee) but act in a quasi-trustee role.

2 Investment objectives

The investment objectives are to maximise investment returns over the long term within specified risk tolerances. Investment returns are defined as the overall rates of return (capital growth and income).

3 Investment style and management

The investment style is to appoint expert fund managers with a clear performance benchmark and place maximum accountability for performance against that benchmark on the Fund manager.

Historically, three active multi-asset managers managed the Fund. This approach had proved effective for the county fund over the longer term and where results had been less good reviews took place and fund managers replaced if appropriate, as happened in 1998.

In 2003 Watson Wyatt, the specialist investment adviser to the Pension Fund, advised that the prevailing fund management arrangements were sub-optimal and that a core-satellite structure should be considered. This structure sub-divides investments into three types, each with a different level of risk and target return profile:

Type of funds	Level of risk	Target return out-performance p.a.
Passive (index-tracker)	Low	0 – 0.5%
Active core	Medium	0.75% - 2.0%
Satellite	High	3% – 4%
TOTAL	Medium	

The **passive core** consists of a range of asset classes where the investment objective is to track a relevant index (e.g. FTSE All-Share for UK equities) and produce a return that is as close as possible to the index return.

The **active core** consists of a range of asset classes where the investment objective is to beat the index by some 0.75% - 2% per annum. Due to the difficulty in finding fund managers that are “best in class” in all types of asset, the active core consists of specialist managers in the key asset classes of UK Equities, Global Equities, Bonds and Property. Specialist managers are known for their investment expertise and returns in any one particular asset type, rather than for a bundle of asset types,

as is the case with multi-asset or balanced managers.

The **satellite structure** contains a number of smaller fund managers specializing in specific equity regions with a higher investment target and, by implication, taking a higher level of risk.

Following an extensive procurement exercise the Fund moved to a core-satellite structure in 2004 (increasing the number of fund managers from 3 to 12). Following a review of the Fund managers in 2006 one of the 2004 mandates was terminated (SG Asset Management).

The following fund managers were in place as at 31 March 2007:

	Manager	Target % of fund
Passive core	Legal and General	29.5
Active core		
UK equity	UBS Global Asset Management	13.0
Global equity 1	Marathon Asset Management	10.0
Global equity 2	UBS Global Asset Management	4.5
Bonds	Western Asset Management	15.0
Property fund of funds	ING Real Estate	8.0
Satellite managers		
UK equity 1	Mirabaud	4.0
UK equity 2	Majedie	4.0
US equity	TCW	3.0
European equity	Schroders	3.0
Pacific Basin inc Japan equity	JP Morgan Fleming	3.0
Emerging markets equity	Citigroup	3.0

The proportion of the Fund allocated to each specialist manager was determined with reference to the overall asset allocation specified in the Fund’s customised benchmark.

The number of new managers appointed under the new structure reflects the need to diversify

by manager and the need to spread risk. the Fund also has a commitment to invest up to 5% of the Fund in private equity or development capital. This allocation is achieved by investing in fund of funds, managed by a number of private equity specialists. The investments are funded through cash flow.

4 Policy on kinds of investment

The Investment Advisers Group, having regard to funding levels, cash needs and risk tolerance, determines the overall fund asset mix. The results of the 2006 ALM were received by the IAG in November 2006. The main changes to the Fund management structure proposed by the study included a reduction in the UK equity weighting (to 50% of the total equity weighting) and a corresponding increase in the global equity weighting. These changes will be reflected in the 2007-2008 SIP.

Acceptable asset classes are

- UK equities
- UK fixed interest
- UK index linked gilts
- UK property through pooled funds
- overseas equities, major classes being
 - North America
 - Europe
 - Pacific rim including Japan
 - Emerging markets
- global bonds
- overseas index linked stocks
- unquoted securities via pooled funds
- emerging market equities via pooled funds, unless specifically authorised
- direct investment in private equity or private equity funds
- use of derivatives and other financial instruments is permitted within pre-agreed limits for specific purposes such as asset allocation switches and currency hedging
- underwriting is permitted provided that the underlying stock is suitable on investment grounds and complies with existing investment criteria

- stock lending is only permitted subject to specific approval.

There are statutory limits on the proportion of the Fund that can be invested in certain types of investment as determined by the Local Government Pension Scheme (Management and Investment of Funds Regulations) 1998 (as amended from time to time).

5 Investment performance targets and Benchmarks

The over-riding aim is to run the Pension Fund in accordance with relevant legislation and the following performance target:

“to outperform the Surrey benchmark performance by 1% per annum over a rolling three year period, with a maximum underperformance of -2% in any one year.”

The Surrey benchmark, against which the Fund’s overall performance is measured, is shown on the following page. The panel considers the Fund’s overall actual performance compared to with what it would have been had the assets been invested in the proportions identified in the following table.

Asset class	Benchmark allocation %	Permitted tolerance range %	Index
UK equities	45	40 – 50	FTSE All Share
Overseas equities			
US/North America	9	5 – 13	FTSE World Index – North America
Europe	9	5 – 13	FTSE World Index – Europe
Japan	6	3 – 9	FTSE World Index – Japan
Pacific Rim	3	0 – 5	FTSE World Index – Asia Pacific
Emerging markets	3	0 – 5	MSCI Index (Emerging Markets)
UK fixed interest gilts	8	5 – 10	FTSE Actuaries Govt. All-Stock
Sterling non-government bonds	8	5 – 10	Merril Lynch All Non-Gilt Index
UK index-linked gilts	1.5	0 – 5	FTSE Actuaries Govt. I-L All-stock
Overseas I-L gilts	1.5	0 – 5	Lehman Bros. Over 5 yrs TIPS (Hedged)
Overseas bonds	1	0 – 5	JP Morgan Global (ex UK) Traded Bond Index
Property	5	0 – 10	HSBC All Balanced Funds
Cash	0	0 – 5	LIBID 7 Day Rate

Individual fund managers have different outperformance targets that reflect the level of risk to be taken by each manager and are summarised in the table below. Individual manager performance is measured with reference to the relevant portion of the benchmark, e.g. the UK equity managers are measured with reference to the FTSE All-Share index, and the relevant individual outperformance target.

Type of funds	Level of risk	Target return out-performance p.a.
Passive (index-tracker)	Low	0 – 0.5%
Active core	Medium	0.75% - 2.0%
Satellite	High	3% – 4%
TOTAL	Medium	

The performance target for the Private Equity Funds is to outperform returns on quoted UK equities, as measured by the FTSE All Share Index, by 2% p.a..

6 Policy on risk

Fund managers are required to implement appropriate risk management measures and to operate in such a way that the possibility of undershooting the performance target is kept within acceptable limits. Active monitoring of individual manager and overall portfolio risk is maintained through the use of an independent risk monitoring service.

7 Policy on balance between different kinds of investment

The Council has set target asset allocation ranges for each kind of investment within the overall benchmark. Fund managers are required to report quarterly their current country, sector or asset allocation positions, whichever is relevant, against their strategy, and to seek approval for variations to their strategies.

8 Policy on realisation of investments

Fund managers are required to maintain portfolios that consist of assets that are readily realisable. Any investment within an in-house or pooled fund, which is not readily tradable, requires specific approval.

9 Monitoring and review

The target funding level is set triennially, consequent upon the actuarial review. The statutory requirement is to move towards 100% funding over a period of time, agreed with the actuary as the average expected future working lifetime of the scheme membership (currently 20 years).

Investment strategy will be reviewed annually, with a major review taking place triennially following the actuarial review. The SIP will also be reviewed annually.

A review of investment management arrangements is carried out every five years.

Investment management performance is reviewed annually upon receipt of the third-party performance information.

The individual manager's current activity and transactions are presented quarterly in discussion with the Investment Advisers Group.

An annual general meeting is held and is open to all fund employers and members.

10 Ethical and environmental investment

The Council wishes to have an active influence on issues of environmental or ethical concern with companies in which the pension fund is a shareholder. It will seek to codify its approach with fund managers and will use the services of specialist agencies as necessary to identify issues of concern. The council expects the Fund managers to take note of the possibility that substantial ethical or environmental considerations may be among those bringing a particular investment decision into the "potentially contentious" category referred to in paragraph 11 below.

11 Corporate governance

The Fund wishes to be an active shareholder and exercise its voting rights to promote and support good corporate governance principles. In practice, managers are delegated authority to exercise the Fund's voting rights in this respect subject to seeking the Council's specific approval in respect of potentially contentious issues (those which receive significant press or media coverage) and reporting quarterly on action taken.

12 Custody

Managers are required to hold cash and stocks in an account managed by Northern Trust, the Fund's independent global custodian, or by agreement otherwise as appropriate. The Pension Fund holds only a minimum working cash balance.

13 Administration

On behalf of the County Council, the Head of Finance is required to exercise continual monitoring of the managers' investment related actions and administration. This includes

- maintaining the investment ledger and suitable accounting procedures for fund assets
- preparing and submitting statistics quarterly for performance measurement independent of the managers
- preparing a quarterly report to Investment Advisers Group and the Audit and Governance Committee
- preparing the audited annual report and accounts for employing bodies – in line with statutory deadlines
- publishing a report on the County website that is available to stakeholders
- maintaining an up to date record of cash balances at Surrey to ensure surplus cash is invested promptly or that resources are available to meet the benefit outflow as it arises.

Contacts

Benefits and contributions

Enquiries should be directed in writing to Pension Services at the following address:

Pensions Unit

Room G59

County Hall

Kingston Upon Thames

Surrey KT1 2EB

Telephone: 020 8541 9289 or 9292

E Mail: pensions@surreycc.gov.uk

Fax: 020 8541 9287

Accounts and investments

Information regarding the accounts and investments can be obtained from the Pension Fund and Treasury Manager on 020 8541 9894.

Pension scheme regulations

1997 Regulations S.I. 1997/1612

Copies may be obtained from:

The Stationery Office Ltd

2nd Floor

St Crispins

Duke Street

Norwich

NR3 1PD

Website:

www.opsi.gov.uk/si/sp1997/19971612.htm

Useful addresses

Registrar of Pension Schemes

PO Box 1NN

Newcastle upon Tyne

NE99 1NN

019 1225 6316

The Pensions Advisory Service (TPAS)

11 Belgrave Road

London

SW1V 1RB

084 5601 2923

Pensions Ombudsman

11 Belgrave Road

London

SW1V 1RB

020 7834 9144

Employee and employer guides

The Department for Community and Local Government has produced guides to the Pension Scheme Regulations.

These are available on request from Pension Services.

National website

www.lgps.org.uk

Glossary of terms

Accruals based accounting

The most commonly used accounting method, which reports income when earned and expenses when incurred, as opposed to cash basis accounting, which reports income when received and expenses when paid.

Active management

A style of management where the Fund manager aims to outperform a **benchmark** by superior **asset allocation**, market timing or **stock selection** (or a combination of these). Compare with **passive management**.

Actuary

An independent consultant who advises the County Council on the financial position of the Fund. See **actuarial valuation**.

Actuarial valuation

This is an assessment done by an **actuary**, usually every three years. The actuary will work out how much money needs to be put into a pension fund to make sure pensions can be paid in the future.

Additional voluntary contribution (AVC)

An option available to individuals to secure additional pensions benefits by making regular payments in addition to the 6% or 5% of basic earnings payable.

Admitted bodies

Employers whose staff can become members of the Fund by virtue of an admission agreement made between the administering authority and the employer.

Annualised return

The rate of return for any given period expressed as the equivalent average return per annum.

Asset allocation

The apportionment of a fund's assets between asset classes and/or world markets. The long-term strategic asset allocation of a fund will reflect the Fund's investment objectives. In the short term, the Fund manager can aim to add value through **tactical asset allocation** decisions.

Attribution

Used to explain the differences between a portfolio's return and a **benchmark** return. Two main factors contribute to this difference: asset allocation strategy and stock selection.

Balanced management

The Fund manager invests in a range of asset classes, as defined by a fund's **benchmark**.

Benchmark

A yardstick against which the investment policy or performance of a fund manager can be compared. The Surrey Fund's benchmark is customised, meaning that it is tailored to the Fund's **liability profile**.

Bond

A debt investment with which the investor loans money to an entity (company or government) that borrows the Funds for a defined period of time at a specified interest rate.

Book cost

The value of an asset as it appears on a balance sheet, equivalent to how much was paid for the asset (less liabilities due). Book cost often differs substantially from **market value**.

Broker

An individual or firm that charges a fee or commission for executing buy and sell orders submitted by an investor.

Commission

A service charge assessed by an agent in return for arranging the purchase or sale of a security or real estate. The commission must be fair and reasonable, considering all the relevant factors of the transaction (Underwriting commission).

Corporate bond

A debt security issued by a corporation, as opposed to those issued by the government.

Corporate Governance

The system by which companies are run, and the means by which they are responsible to their shareholders, employees and other stakeholders.

Core-satellite

Where the bulk of a fund's assets (core) are invested in a controlled manner to provide stable returns (possibly as a passive fund or lower risk active fund). The remainder of the Fund's assets (often called the satellite portfolio) can then be managed in a more aggressive way in search of higher **returns**.

Creditors

Amounts owed by the pension fund.

Custody

Safe-keeping of securities by a financial institution. The custodian keeps a record of the client's investments and may also collect income, process tax reclaims and provide other services such as performance measurement.

Debtors

Amounts owed to the pension fund.

Derivative

Used to describe a specialist financial instrument such as **options** or **futures contracts**. Financial instruments are agreements to buy or sell something, under terms laid out in a contract.

Diversification

A risk management technique that mixes a wide variety of investments within a portfolio. It is designed to minimize the impact of any one security on overall portfolio performance.

Dividend

Distribution of a portion of a company's earnings, decided by the board of directors, to a class of its shareholders. The amount of a dividend is quoted in the amount each share receives or in other words dividends per share.

Dividend yield

An indication of the income generated by a share, calculated as annual dividend per share/price per share.

Emerging markets

There are about 80 stock markets around the world of which 22 markets are generally considered to be mature. The rest are classified as emerging markets.

Equity

Stock or any other security representing an ownership interest.

Ex-dividend

Purchase of shares without entitlement to current dividends. This entitlement remains with the seller of the shares.

Ex-post

A term that refers to past events or actual returns. Often used in relation to **tracking error**.

Final Salary Scheme

An employer pension scheme, the benefits of which are linked to length of service and the final salary of the member (also known as defined benefit).

Fixed interest

A loan with an interest rate that will remain at a predetermined rate for the entire term of the loan. See bond.

FTSE All-Share

An arithmetically weighted index of leading UK shares (by market capitalisation) listed on the London Stock Exchange (LSE). The FTSE 100 Index covers only the largest 100 companies.

Funding level

A comparison of a scheme's assets and liabilities.

Futures contract

A contract to buy goods at a fixed price and on a particular date in the future. Both the buyer and seller must follow the contract by law.

Gilts

The familiar name given to sterling, marketable securities (or bonds) issued by the British Government.

Hedge

Making an investment to reduce the risk of adverse price movements in an asset. Normally, a hedge consists of taking an offsetting position in a related security, such as a **futures contract**.

Index linked

A **bond** which pays a **coupon** that varies according to some underlying index, usually the consumer price index.

LGPS

Local Government Pension Scheme.

LSE

London Stock Exchange

Mandate

The agreement between a client and investment manager laying down how the portfolio is to be managed, including performance targets.

Market Value

A security's last reported sale price (if on an exchange) i.e. the price as determined dynamically by buyers and sellers in an open market. Also called market price.

Option

The name for a contract where somebody pays a sum of money for the right to buy or sell goods at a fixed price by a particular date in the future. However, the goods do not have to be bought or sold.

Passive management

A style of fund management that aims to construct a portfolio to provide the same return as that of a chosen index. Compare with **active management**.

Pension fund

A fund established by an employer to facilitate and organise the investment of employees' retirement funds contributed by the employer and employees. The **pension fund** is a common asset pool meant to generate stable growth over the long term, and provide pensions for employees when they reach the end of their working years and commence retirement.

Private equity

When equity capital is made available to companies or investors, but not quoted on a stock market. The Funds raised through private equity can be used to develop new products and technologies, to expand working capital, to make acquisitions, or to strengthen a company's balance sheet. Also known as **development capital**.

Property unit trusts

Pooled investment vehicles that enable investors to hold a stake in a diversified portfolio of properties.

Resolution bodies

Scheme employers with the power to decide if an employee or group of employees can join the scheme.

Return

Synonymous with profit, be it income received, capital gain or income and capital gain in combination. Usually expressed as a percentage of the nominal value of the asset.

Risk

The likelihood of performance deviating significantly from the average. The wider the spread of investment in an investment sector or across investment sectors, i.e. the greater the diversification, the lower the risk.

Satellite managers

See **core-satellite**.

Scheme employers

Local authorities and other similar bodies whose staff automatically qualify to become members of the pension fund.

Security

An investment instrument, other than an insurance policy or fixed annuity, issued by a corporation, government, or other organisation, which offers evidence of debt or equity. Socially Responsible Investment (SRI) Investments or funds containing stock in companies whose activities are considered ethical.

Specialist manager

A fund management arrangement whereby a number of different managers each concentrate on a different asset class. A specialist fund manager is concerned primarily with **stock selection** within the specialist asset class. **Asset allocation** decisions are made by the investment committee, their consultant or by a specialist tactical asset allocation manager (or combination of the three).

Stock

A type of security that signifies ownership in a corporation and represents a claim on part of the corporation's assets and earnings. Also known as shares or **equity**.

Stock selection

The process of deciding which stocks to buy within an asset class.

Tracking error

An unplanned divergence between the price behaviour of an underlying stock or portfolio and the price behaviour of a benchmark. Reflects how closely the make-up of a portfolio matches the make-up of the index that it is tracking.

Transaction costs

Those costs associated with managing a portfolio, notably brokerage costs and taxes.

Transfer value

The amount transferred to/from another pension fund should a member change employment. The amount transferred relates to the current value of past contributions.

Transition

To move from one set of investment managers to another.

Underwriting

The process by which investment bankers raise investment capital from investors on behalf of corporations and governments that are issuing securities (both equity and debt).

Unit trust

A pooled fund in which investors can buy and sell units on an ongoing basis.

Unlisted security

A security which is not traded on an **exchange**.

Unquoted security

A share which is dealt in the market but which is not subject to any listing requirements and is given no official status.

Unrealised gains/(losses)

The increase/(decrease) at year-end in the market value of investments held by the Fund since the date of their purchase.

Yield

The rate of income generated from a **stock** in the form of **dividends**, or the effective rate of interest paid on a **bond**, calculated by the **coupon** rate divided by the bond's market price. Furthermore, for any investment, yield is the annual rate of return expressed as a percentage.

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